International Political Economy(CESt 2051):

UNIT ONE: The Subject Matter and Essence of IPE

✪ Unit Introduction

The parallel existence and mutual interaction of the state and the market in the modern world create political economy; without both the state and the market there will be no political economy. In the absence of the state, the price mechanism and the market forces determine the outcome of economic activities, which would become the pure world of economists. In the absence of the market, the sate or its equivalent would allocate economic resources; this would be the pure world of political scientists. Although neither world can ever exist in a pure form, the relative influence of the state or the market changes overtime in different circumstances.

The purpose of this unit is to enable you understand the meaning, nature, scope and significance of international political economy. This unit is divided in to two broad sections. In the first section, the focus will be on the controversies surrounding the concept of political economy in its evolution from the classical period and then an attempt will be made to shed light on the specific meaning of the concept of political economy in political science and particularly in international political economy. The second section deals with the interaction between international economics and international politics and how this creates a unique field of study, international political economy. In this last section, we will also talk about the variety of issues involved in the study of international political economy.

Section One: What Is Political Economy?

✪ Section overview

From its original application by classical economists as the science of economics and statesman, the concept of political economy has grown wider in its scope and meaning. At the turn of the 21st century, despite the mushrooming of various theories and strands of thoughts, scholars do not agree as what essentially constitutes political economy. The purpose of this section is introduce you to this controversy in order to enable you appreciate the evolution through which the very term has gone through.

1.1 Political Economy Defined

? Dear student, what do you think is political economy? And how different is political economy from the science of economics?

The very term "political economy" is fraught with controversy. Let us begin with the nature of "political economy" and contrast it with "economics" before turning to the subject of international political economy itself.

During the last two centuries several different definitions of the term "political economy" have been set forth. A brief summary of the changes in those definitions provides insight into the nature of the subject. For Adam Smith in *The Wealth of Nations* (1776), political economy was a "branch of the science of a statesman or legislator" and a guide to the prudent management of the national economy, or as John Stuart Mill, the last major classical economist, commented, political economy was the science that teaches a nation how to become rich. These thinkers emphasized the wealth of *nations*, and the term "political" was as significant as the term "economy." Adam Smith and classical economists used it to mean what today is called the "science of economics".

In the late nineteenth century, this broad definition of what economists study was narrowed considerably. Alfred Marshall, the father of modern economics, turned his back on the earlier emphasis on the nation as a whole and on the "political" as important. In his highly influential *Principles of Economics* (1890), Marshall substituted the present-day term "economics" for "political economy" and greatly restricted the domain of economic science. Following Marshall's precept that economics was an empirical and value-free science, his student Lionel Robbins in *The Nature and Significance of Economic Science* (1932) provided the definition to which most present-day economists subscribe: "Economics is the science which studies human behavior as a relationship between ends and scarce means which have alternative uses." In more modern terminology, economics is defined by economists as a universal science of decision-making under conditions of constraint and scarcity.

At the end of the twentieth century, the term "political economy" has come back into fashion even among economists, but there are important differences from earlier usages. There is also considerable controversy over the meaning of the term. For many neoliberal economists (especially the Chicago School economists), political economy means a significant broadening of the scope or subject matter that economists' study. These economists have greatly extended the social domain to which the methods or formal models of traditional economics are applicable. The underlying assumptions regarding motivation and the analytical tools of mainstream economics, they argue, are pertinent to the study of all (or at least almost all) aspects of human behavior.

This trend is associated at least with three different schools of economists, which employ an economic approach to human behavior: neoclassical institutionalism, the public-choice school, and what is sometimes called the “new political economy”. Neoclassical institutionalism attempts to explain the origin, evolution, and functioning of all types of institutions (social, political, economic) as the result of the maximizing behavior of rational individuals. The public-choice school is also interested in applying the methods of formal economics to analysis of political behavior and institutions, especially to the political organization of free men. The new political economy is interested primarily in the political determinants of economic policy.

A very different concept of political economy is used by Marxists who believe that the discipline of economics has become “too formal, mathematical, and abstract”. The study of economics as the development of formal models has become largely irrelevant to the understanding and solving of real social and economic problems. A major reason for this isolation of economics from the real world, they argue, is that economics neglects the historical, political, and social settings in which economic behavior takes place. As a consequence, some assert that economics, at least as it is taught and practiced in traditional departments of economics, has little relevance to the larger society and its needs. Closely associated with this general criticism is what many critics regard as the pretension of economics to be a “science” modeled on physics and other natural sciences. Economics, they contend, cannot be value-free, and economists should not pretend that it is.

According to Marxists and others, conventional economics reflects the values and interests of the dominant groups of a capitalist society. Rather than being value-free, economics is alleged to be infused with an implicit conservative social and political bias that emphasizes market and efficiency and neglects such social problems as inequality of income and chronic unemployment. In the opinion of Robert Heilbroner and William Milberg, contemporary economics is nothing but a “handmaiden of modern Western capitalism”, and its primary purpose is to make this troubled system work.

By the end of the twentieth century, the term “political economy” had been given three broad and different meanings. For some scholars, especially *economists*, political economy referred *to the application to all types of human behavior, including behaviors that would not be classified by others as ‘economic’, of the methodology of formal economics*; that is, methodological individualism or the rational actor model of human behavior. Other scholars used the term to mean employment of a specific economic theory(ies) to explain social behavior.

Political scientists, on the other hand, believe that social and political affairs cannot be reduced to a subfield of economics. Rather, *political economy refers primarily to questions generated from the interactions of economic and political affairs*. Proponents of this broad approach to the subject are eclectic in their choice of subject matter and methods (economic, historical, sociological, political, etc.). Therefore, in political science, what we call political economy simply indicates *a set of questions to be examined by means of an eclectic mixture of analytic methods and theoretical perspectives*.

Fundamental differences between economics and political economy are exemplified in their differing definitions of the economy to be studied, of the basic economic entities or actors, and of the forces responsible for economic and, more broadly, sociopolitical change. Members of each academic specialization differ in their perspectives on economic affairs, questions asked, and methods employed. The differences, illustrated in the coming discussion, are important because they profoundly influence the ways in which economists and political economists study economic affairs at both the domestic and international levels.

1.2 Scope and Nature of PE

1.2.1 Market, State and Political Economy

? Dear student, what is the market and what is the state? How this does creates what we call political economy?

The study of political economy focuses on the market and its relationship to the state because the world market economy is critical to international relations in the modern era; in any society the key issue in economic debates is the appropriate role of internal and external market forces. So far in your stay in the department, we believe that, you are familiar with the notion of the state and thus we are going to the definition of the state. The definition of the market, however, will be given in the proceeding paragraphs.

Although a market is an abstract concept, a market economy can be defined as one in which goods and services are exchanged and prices are determined. Its essence, as one economist has put it, is “the making of a price by haggling between buyers and sellers’. Phrased in more formal terms, a market is “the whole of any region in which buyers and sellers are in such free intercourse with one another that the prices of the same goods tend to equality easily and quickly”. Its specific characteristics are dependent upon its degree of openness and the intensity of the competition among producers and sellers. Markets differ with respect to the freedom of participants to enter the market and also the extent to which individual buyers or sellers can influence the terms of the exchange. Thus, a perfect or self-regulating market is one that is open to all potential buyers or sellers and one in which no buyer or seller can determine the terms of the exchange, although such a perfect market has never existed, it is the model of the world implicit in the development of economic theory.

Three characteristics of a market economy are vital to the conception of market: (I) the critical role of relative prices in the exchange of goods and services, (2) the centrality of competition as a determinant of individual and institutional behavior, and (3) the importance of efficiency in determining the survivability of economic actors. From these flow the profound consequences of a market for economic, social, and political life.

Whereas economists regard an economy as a market composed of impersonal economic forces, specialists in political economy interpret it as a sociopolitical system populated by powerful actors. Such conceptual differences distinguish the study of economics from that of international political economy (IPE).

The *neoclassical economic interpretation* is that the economy is a market or a collection of markets composed of impersonal economic forces over which individual actors, including states and corporations, have little or no control. For economists the economy is nothing more than a collection of flexible wages, prices, interest rates, and similar forces that move up and down allocating resources to their profitable use as buyers and sellers rationally pursue their own interests. Such an economic universe is a self-regulating and self-contained system composed solely of changing prices and quantities to which individual economic actors respond. Economic actors are assumed to be “price-takers” who seek to maximize, or at least satisfy, their private interests as they respond to changes in relative prices or to changes in economic constraints and opportunities.

The *political economy interpretation on the other hand* defines the economy as a sociopolitical system composed of powerful economic actors or institutions such as giant firms, powerful labor unions, and large agribusinesses that are competing with one another to formulate government policies on taxes, tariffs, and other matters in ways that advance their own interests. And the most important of these powerful actors are national governments. In this interpretation, there are many social, political, or economic actors whose behavior has a powerful impact on the nature and functioning of markets. This conception of the economy as an identifiable social and political structure composed of powerful actors is held by many citizens and by most social scientists other than professional economists. The role of institutions in determining economic behavior and outcomes is of particular interest in the political economy interpretation.

The study of political economy requires integration of these two fundamentally different meanings of "economy." Both the neoclassical and the political economy interpretations of economic activities are necessary and important ingredients in the effort to understand how the economy functions. Impersonal markets and powerful actors interact to produce those economic and political outcomes of interest to students of political economy. The study of political economy requires an understanding of how markets work and how market forces affect economic outcomes as well as an understanding of how powerful actors, of which the nation-state is by far the most important, attempt to manipulate market forces to advance their private interests.

The science of economics, as it has been developed by generations of professional economists, possesses highly useful analytical tools and a rich body of theoretical insights (models) for understanding markets. The scope of economic science, however, is too limited and its theories much too abstract for the purposes of international political economy. The strength of political science lies in its broad emphasis on the "realities" of the universal struggle among human beings, groups, and states for power and position. Its weakness lies in the intuitive nature of its methods and its limited theoretical foundations. The polity is much more influenced by economic developments than many political scientists have appreciated, and the economy is much more dependent upon social and political developments than economists in general have admitted. Recognition of the interrelationships between the two spheres has led to increased attention from historians and social scientists.

The study of political economy and international political economy requires an analytic approach that takes into account economics, political science, and other social sciences. It must incorporate the many economic, political, and technological factors that determine, or at least influence, the nature and dynamics of the international economy.

1.2.2 Embeddedness of the Economy and the Political Consequences of the Market

? Dear student, what do you think are the political consequences of the market?

The central idea that markets are embedded in larger sociopolitical systems underlies the basic interpretation of both political economy and international political economy. The government, powerful domestic interests, and historical experiences determine the purpose of the economy and establish the parameters within which the market (price mechanism) functions. Contrary to economists' belief that economic activities are universal in character and essentially the same everywhere, the specific goals of economic activities are in actuality socially determined and differ widely over the face of the earth. For example, although neoclassical economists assert that the primary purpose of economic activities is to satisfy the desires of individual consumers, this characterization applies to the United States but not to every other economy. Japan and many Asian societies, for example, place a high priority on the welfare of the community and on social cohesion.

In addition to determining the purpose of economic activity, the sociopolitical system and a society's values determine the role that the market or price mechanism in a particular society legitimately plays and the socially approved ways in which economic objectives may be pursued. Every society has values and beliefs that circumscribe the ways in which the market is permitted to function; societies establish rules and set boundaries that govern the range of activities in which the price mechanism is considered legitimate; what is considered to be "fair" economic behavior in one society may not be considered fair in another. For example, bribery is a serious offense in the United States, but what Westerners would call "bribery" has long been a normal and accepted business practice in China. Such national differences have been a major source of misunderstandings and even of political conflict as national economies have become more closely linked to one another through trade and investment.

The essence of economics and its implications for social and political organization, as viewed by economists, are contained in what Samuelson has called "the most beautiful idea" in economic theory, namely, David Ricardo's law of comparative advantage. The implication of this simple concept is that domestic and international society should be organized in terms of relative efficiencies. It implies a universal division of labor based on specialization, in which the most humble person and the most resource-poor nation can find a place and eventually prosper. A fundamental harmony of interest among individuals, groups, and states is assumed to underlie the growth and expansion of the market and of economic interdependence.

In the real world, divided among many different and frequently conflicting groups and states, markets have an impact vastly different from that envisaged by economic theory, and they give rise to powerful political reactions. Economic activities affect the political, social, and economic well-being of various groups and states differentially. The real world is a universe of exclusive and frequently conflicting loyalties and political boundaries in which the division of labor and the distribution of its benefits are determined as much by power and good fortune as they are by the laws of the market and the operation of the price mechanism. The assumption of a fundamental harmony of interest is most frequently invalid, and the growth and expansion of markets in a socially and politically fragmented globe have profound consequences for the nature and functioning of international politics. What then are these consequences that give rise to political responses?

One consequence of a market economy for domestic and international politics is that it has highly disruptive effects on a society; the introduction of market forces and the price mechanism into a society tends to overwhelm and even dissolve traditional society relations and institution; the competition of the efficient drives out the inefficient and forces all to adapt to new ways.

Further, markets are subject to cyclical fluctuations and disturbances over which the society may have little control; specialization and its resulting dependencies increase vulnerabilities to unpleasant events. In short, markets constitute a powerful source of sociopolitical change and produce equally powerful response as societies attempt to protect themselves against market forces. Therefore, no state, however liberal its preferences, permits the full and unregulated development of market forces.

Another consequence of a market economy is that it significantly affects the distribution of wealth and power within and among societies. In theory, all can take advantage of market opportunities to better themselves. In practice, however, individuals, groups, or states are differently endowed and situated to take advantage of these opportunities and therefore the growth of wealth and the spread of economic activities in a market system tend to be uneven, favoring one state or another. Thus, states attempt to guide market forces to benefit their own citizens, resulting, at least in the short run, in the unequal distribution of wealth and power among the participants in the market and the stratification of societies in the international political economy.

Another important consequence of a market economy for states is due to the fact that economic interdependence establishes a power relationship among groups and societies. A market is not politically neutral; its existence creates economic power which one actor can use against another. Economic interdependence creates vulnerabilities that can be exploited and manipulated. In the words of Albert Hirschman, "the power to interrupt commercial or financial relations with any country… is the root cause of the influence or power position which a country acquires in other countries" through its market relations. In varying degrees, then, economic interdependence establishes hierarchical dependency and power relations among groups and national societies. In response to this situation, states attempt to enhance their own independence and to increase the dependence of other states.

A market economy confers both benefits and costs on groups and societies. On the one hand, economic specialization and a division of labor foster economic growth and an increase in the wealth of market participants, although, gains are unevenly distributed, in general everyone benefits in absolute terms. Therefore few societies choose to absent themselves from participation in the world economic system. Yet, on the other hand, a market economy also imposes economic, social, and political costs on particular groups and societies, so that in relative terms, some benefit more than others. Thus, states seek to protect themselves and limit the costs to themselves and their citizens. The struggle among groups and states over the distribution of benefits and costs has become a major feature of international relations in the modern world.

Section Two: International Political Economy

✪ Section overview

Having introduced the meaning, nature and scope of political economy in the previous section, let us now turn to international political economy. In this section, first we will introduce you with the two important themes of international political economy; international politics and international economics. In the second part you will be introduced to the variety of issues and sets of problems that IPE deals with.

2.1 International Economics and International Politics

? Dear student how do you think is the interaction between international economics and international politics results in IPE?

It is hard to imagine a world without International Political Economy because the mutual interaction of International Politics (or International Relations) and International Economics is today widely appreciated and the subject of much theoretical research and applied policy analysis. The political actions of nation-states clearly affect international trade and monetary flows, which in turn affect the environment in which nation-states make political choices and entrepreneurs, make economic choices. It seems impossible to consider important questions of International Politics or International Economics without taking these mutual influences and effects into account.

And yet scholars and policy-makers often do seem to think about International Economics without much attention to International Politics and vice versa. Economists often assume away state interests while political scientists sometimes fail to look beyond the nation-state; both miss the dynamic interaction of state and market that characterizes political economy.

The mutual astigmatism that hide International Politics and International Economics from each other cleared up a bit in the 1970s as a number of dramatic international events made plain how tightly the two fields were intertwined. The oil embargoes of the 1970s and the breakdown of the Bretton Woods monetary system are frequently cited as key events in IPE's development as a field of study. These events posed practical and theoretical problems that necessarily forced scholars and policy-makers to consider economics and politics together.

Other events such as the Third World debt crisis, the fall of communist regimes, the rise of the East Asian Newly Industrialized Countries (NICS), the expansion of the European Union, and the financial crises in Mexico, Russia, and East Asia all provided impetus for the growth and development of IPE studies. The simple divisions between state and market, domestic and international, and politics and economics were no longer applicable to a wide range of issues. An increasingly complex world required a complex approach to analysis, which IPE provided.

2.2 The Issues of International Political Economy

? Dear student what do you think are the major issues that we deal in IPE?

Whereas powerful market forces in the form of trade, money, and foreign investment tend to jump national boundaries, to escape political control, and to integrate societies, the tendency of government is to restrict, to channel, and to make economic activities serve the perceived interests of the state and of powerful groups within it. The logic of the market is to locate economic activities where they are most productive and profitable; the logic of the state is to capture and control the process of economic growth and capital accumulation.

Debate has raged for several centuries over the nature and consequences of the clash of the fundamentally opposed logic of the market and the state. The conflicting interpretations represent three fundamentally different ideologies of political economy, which the next chapter will discuss.

The inevitable clash gives rise to three general and interrelated issues that pervade the historic controversies in the field of international political economy. The first issue is concerned with the economic and political causes and effects of the rise of a market economy. Under what conditions does a highly interdependent world economy emerge? Does it promote harmony or cause conflict among nation-states? Is a hegemonic power required if cooperative relations among capitalist states are to be ensured, or can cooperation arise spontaneously from mutual interest? On this issue theorists of different schools of thought have profoundly conflicting views.

The second issue pervading the subject of international political economy is the relationship between economic change and political change. What are the effects on international political relations and what problems are associated with structural changes in the global locus of economic activities, leading economic sectors and cyclical rates of economic growth? And, vice versa, how do political factors affect the nature and consequences of structural changes in economic affairs?

The third issue revolves around the significance of a world market economy for domestic economies. What are its consequences for the economic development, economic decline, and economic welfare of individual societies? How does the world market economy affect the economic development of the less developed countries and the economic decline of advanced economies? What is its effect on domestic welfare? How does it affect the distribution of wealth and power among national societies? Does the functioning of the world economy tend to concentrate wealth and power, or does it tend to diffuse it?

UNIT SUMMARY

In this unit we have defined political economy as the interaction of the market and the state. Both components are necessary, and one cannot comprehend how either domestic or international economies function unless he or she understands both how markets work and how states and other actors attempt to manipulate markets to their own advantage. As we stated above, markets have an inherent logic of their own as they respond to changes in relative prices, constraints, and opportunities. Therefore, to analyze the functioning of an economy, one must begin with at least a rudimentary knowledge of how the discipline of economics understands the economy as a market or price mechanism.

Scholars and other individuals differ, however, on the nature of the relationship between economic and political affairs. Although many positions can be identified, almost everyone tends to fall into one of three contrasting perspectives, ideologies, or schools of thought. They are liberalism, nationalism, and Marxism, and the next chapter will evaluate their strengths and limitations. In particular, the fundamental challenge raised by nationalism and especially Marxism with respect to the prospects for the continuation of the postwar liberal international economy will be considered.

UNIT TWO

Theoretical Perspectives in International Political Economy

✪ Unit Introduction

There have been traditionally three broad categories of theoretical approaches to the study of international political economy- liberalism, nationalism and Marxism. Over the past century and a half, liberalism, nationalism, and Marxism have divided humanity. The conflict among these three moral and intellectual positions has revolved around the role and significance of the market in the organization of society and economic. The three approaches differ on a broad range of questions such as; what are the significance of the market for economic growth and the distribution of wealth among groups and societies? What ought to be the role of markets in the organization of domestic and international society? What is the effect of the market system on issues of war or peace? These and similar questions are central to discussions of international political economy.

These three approaches are fundamentally different in their conceptions of the relationships among society, state, and market, and it may not be an exaggeration to say that every controversy in the field of international political economy is ultimately reducible to differing conceptions of these relationships. The intellectual clash is not merely of historical interest. Economic liberalism, Marxism, and economic nationalism are all very much alive at the end of the twentieth century; they define the conflicting perspectives that individuals have with regard to the implications of the market system for domestic and international society. Many of the issues that were controversial in the eighteenth and nineteenth centuries are once again being intensely debated. It is important to understand the nature and content of these contrasting "perspective" of political economy.

The term "ideology" or "perspective" is used rather than "theory" because each position entails a total belief system concerning the nature of human beings and society and is thus akin to what Thomas Kuhn has called a paradigm. As Kuhn demonstrates, intellectual commitments are held tenaciously and can seldom be dislodged by logic or by contrary evidence. This is due to the fact that these commitments or ideologies allege to provide scientific descriptions of how the world does work while they also constitute normative positions regarding how the world should work. Although scholars have produced a number of "theories" to explain the relationship of economics and politics, these three stand out and have had a profound influence on scholarship and political affairs. In this unit an attempt will be made to shed light on these theories. Hence, this unit is divided in to three sections in which liberalism, economic nationalism and Marxism will be discussed in the first, second and third sections respectively.

Section One: Liberalism

✪ Section overview

Dear student welcome to the first section of unit two. As we have mentioned earlier in this section the focus is one of the classical perspective in IPE: liberalism. Liberalism, which emerged from the enlightenment in the writings of Adam Smith and others, was a reaction to mercantilism (the economic philosophy of the absolutist sates in Europe) and has become embodied in orthodox economics (what is often called the modern science of economics). It assumes that politics and economics exist, at least ideally, in separate spheres; it argues that markets in the interest of efficiency, growth, and consumer choice should be free from political interference.

1.1 The Liberal Perspective

? Dear distance learner, what do you think liberalism represents?

Some scholars assert that there is no such thing as a liberal theory of political economy because liberalism separates economics and politics from one another and assumes that each sphere operates according to particular rules and logic of its own. This view is itself, however, an ideological position and liberal theorists do in fact concern themselves with both political and economic affairs. Whether it is made explicit in their writings or is merely implicit, one can speak of a liberal theory of political economy.

There is a set of values from which liberal theories of economics and of politics arise, in the modern world these political and economic values have tended to appear together. Liberal economic theory is committed to free markets and minimal state intervention, although, as will be pointed out below, the relative emphasis on one or the other may differ. Liberal political theory is committed to individual equality and liberty, although again the emphasis may differ. We are primarily concerned here with the economic component of liberal theory.

The liberal perspective on political economy is embodied in the discipline of economics as it has developed in Great Britain, the United States, and Western Europe. From Adam Smith to its contemporary proponents, liberal thinkers have shared a coherent set of assumptions and beliefs about the nature of human beings, society, and economic activities. Liberalism has assumed many forms- classical, neo-classical, Keynesian, monetarist, Austrian, rational-expectation, etc. These variants range from those giving priority to equality (tending toward social democracy and state interventionism to achieve this objective) to those stressing liberty and non interventionism at the expense of social equality. All forms of economic liberalism, however, are committed to the market and the price mechanism as the most efficient means for organizing domestic and international economic relations. Liberalism may, in fact, be defined as a doctrine and set of principles for organizing and managing a market economy in order to achieve maximum efficiency, economic growth, and individual welfare.

Economic liberalism assumes that a market arises spontaneously in order to satisfy human needs and that, once it is in operation, it functions in accordance with its own internal logic. Human beings are by nature economic animals, and therefore markets evolve naturally without central direction. As Adam Smith put it, it is inherent in humankind to “truck, barter and exchange.” To facilitate exchange and improve to “truck, barter and exchange their well-being, people create markets, money, and economic institutions.

The rationale for a market system is that it increases economic efficiency, maximizes economic growth, and thereby improves human welfare. Although liberals believe that economic activity also enhances the power and security of the state, they argue that the primary objective of economic activity is to benefit individual consumers. Their ultimate defense of free trade and open markets is that they increase the range of goods and services available to the consumer.

The fundamental premise of liberalism is that the individual consumer, firm, or household is the basis of society. Individuals behave rationally and attempt to maximize or satisfy certain values at the lowest possible cost to themselves. Rationality applies only to endeavor, not to outcome. Thus, failure to achieve an objective due to ignorance or some other cause does not, according to liberals, invalidate their premise that individuals act on the basis of a cost/benefit or means/ ends calculus. Finally, liberalism argues that an individual will seek to acquire an objective until market equilibrium is reached, that is, until the costs associated with achieving the objective are equal to the benefits. Liberal economists attempt to explain economic and, in some cases, all human behavior on the basis of these individualistic and rationalistic assumptions.

Liberalism also assumes that a market exists in which individuals have complete information and are thus enabled to select the most beneficial course of action. Individual producers and consumers will be highly responsive to price signals, and this will create a flexible economy in which any change in relative prices will elicit a corresponding change in patterns of production, consumption, and economic institutions; the latter are conceived ultimately to be the product rather than the cause of economic behavior. Further, in a truly competitive market, the terms of exchange is voluntary, both parties benefit. In colloquial terms, a "free exchange is no robbery."

Economics, or rather the economics taught in most universities (what Marxists call orthodox or bourgeois economics), is assumed to be an empirical science of maximizing behavior. Behavior is believed to be governed by a set of economic "laws" that are impersonal and politically neutral; therefore, economics and politics should and can be separated in to two distinct spheres. Governments should not intervene in the market except where a "market failure" exists or in order to provide a so-called public or collective good.

A market economy is governed principally by the law of demand. This "law" (or, if one prefers, assumption) holds that *people will buy more of a good if the relative price falls and buy less if it rises*; people will also *tend to buy more of a good as their relative income rises and less as it falls*. Any development that changes the relative price of a good or the relative income of an actor will create an incentive or disincentive to acquire (or produce) more or less of the good; this law in turn has profound ramifications throughout the society. Although certain exceptions to this simple concept exist, it is fundamental to the operation and success of a market system of economic exchange.

On the supply side of the economy, liberal economics assumes that individuals pursue their interests in a world of *scarcity and resource constraints*. This is a fundamental and inescapable condition of human existence. Every decision involves an opportunity cost, a tradeoff among alternative uses of available resources. The basic lesson of liberal economics is that "there is no such thing a free lunch"; to gift something one must be willing to give up something else.

Liberalism also assumes that a market economy exhibits a powerful tendency toward *equilibrium and inherent stability*, at least over the long term. This "concept of a self-operating and self-correcting equilibrium achieved by a balance of forces in a rational universe" is a crucial one for the economists' belief in the operation of markets and the laws that are believed to govern them. If a market is thrown into a state of disequilibrium due to some external (Exogenous) factor such as a change in consumer tastes or productive technology, the operation of the price mechanism will eventually return it to a new state of equilibrium. Prices and quantities will once again balance one another. Thus, a change in either the supply or the demand for a good will elicit corresponding changes in the price of the good. The principal technique of modern economic analysis, comparative statics, is based on this assumption of a tendency toward systemic equilibrium.

An additional liberal assumption is that a basic long-term harmony of interests underlies the market competition of producers and consumers, a harmony that will supersede any temporary conflict of interest. Individual pursuit of self-interest in the market increases social well-being because it leads to the maximization of efficiency, and the resulting economic growth eventually benefits all. Consequently, everyone will gain in accordance with his or her contribution to the whole, but, it should be added, not everyone will gain equally because individual productivities differ. Under free exchange, society as a whole will be wealthier, but individuals will be rewarded in terms of their marginal productivity and relative contribution to the overall social product.

Finally, most present day liberal economists believe in progress, defined most frequently as an increase in wealth per capita. They assert that the growth of a properly functioning economy is linear, gradual and continuous. Although political or other events- wars, revolution, or natural disasters can dramatically disrupt this growth path, the economy will return eventually to a stable pattern of growth that is determined principally by increases in population, resources, and productivity.

Moreover, liberals see no necessary connection between the process of economic growth and political developments such as war and imperialism; these political evils affect and may be affected by economic activities, but they are essentially caused by political and not by economic factors. For example, liberals do not believe that any causal relationship existed between the advance of capitalism in the late nineteenth century and the upheavals of imperialism after 1870 and the outbreak of the First World War.

Liberals believe economics is progressive and politics is retrogressive. Thus they conceive of progress as divorced from politics and based on the evolution of the market.

On the basis of these assumptions and commitments, modern economists have constructed the empirical science of economics. Over the past two centuries, they have deduced the "laws" of maximizing behavior, such as those of the theory of comparative advantage, the theory of marginal utility, and the quantity theory of money. As Arthur Lewis has commented, economists discover new laws at the rate of about one per quarter century. These "laws" are both contingent and normative. They assume the existence of an economic man- a rational, maximizing creature. Further, these laws are normative in that they prescribe how a society must organize itself and how people must behave if they are to maximize the growth of wealth. Both individuals and societies may violate these laws, but they do so at the cost of productive efficiency. The normative commitment to the market has spread from its birthplace in Western civilization to embrace an increasingly large portion of the globe.

In essence, liberals believe that trade and economic intercourse are a source of peaceful relations among nations because the mutual benefits of trade and expanding interdependence among national economies will tend to foster cooperative relations. Whereas politics tends to divide, economics tends to unite peoples. A liberal international economy will have a moderating influence on international politics as it creates bonds of mutual interests and a commitment to the status quo. However, it is important to emphasize again that although everyone will, or at least can, be better off in “absolute” terms under free exchange, the “relative” gains will differ. It is precisely this issue of relative gains and the distribution of the wealth generated by the market system that has given rise to economic nationalism and Marxism as rival doctrines.

Section Two: Economic Nationalism

✪ Section overview

In highly oversimplified terms, economic nationalism (or, as it was originally called, mercantilism), which developed from the practice of statesmen in the early modern period, assumes and advocates the primacy of politics over economics. It is essentially a doctrine of state building and asserts that the market should be subordinate to the pursuit of state interests. It argues that political factors do, or at least should, determine economic relations. The discussion that follows is a short description of

2.1 The Nationalist Perspective

? Dear student, what do you think is the major premises of the nationalist perspective? Economic nationalism like economic liberalism has undergone several metamorphoses (changes) over the past several centuries. Its labels have also changed: mercantilism, statism, protectionism, the German Historical School, and, recently, New Protectionism. Throughout all these manifestations, however, runs a set of themes or attitudes rather than a coherent and systematic body of economic or political theory.

Its central idea is that economic activates are and should be subordinate to the goal of state building and the interests of the state. All nationalists ascribe to the primacy of the state, of national security, and of military power in the organization and functioning of the international system. Within this general commitment two basic positions can be discerned. Some nationalists consider the safeguarding of national economic interests as the minimum essential to the security and survival of the state. For lack of a better term, this generally defensive position may be called "benign" mercantilism. On the other hand, there are those nationalists who regard the international economy as an arena for imperialist expansion and national aggrandizement. This aggressive form may be termed "malevolent" mercantilism. The economic policies of Nazi economic minister Hjalmar Schacht toward Eastern Europe in the 1930s were of this type.

Although economic nationalism should be viewed as a general commitment to state building, the precise objectives pursued and the policies advocated have differed in different times and in different places. Yet, as Jacob Viner has cogently argued, economic nationalist (or what he calls mercantilist) writers share convictions concerning the relationship of wealth and power:

> *I believe that practically all mercantilists, whatever the period, country, or status of the particular individual, would have subscribed to all of the following propositions: (1) wealth is an absolutely essential means to power, whether for security or for aggression; (2) power is essential or valuable as a means to the acquisition or retention of wealth; (3) wealth and power are each proper ultimate ends of national policy; (4) there is long-run harmony between these ends, although in particular circumstances it may be necessary for a time to make economic sacrifices in the interest of military security and therefore also of long-run prosperity (Viner, I958, p.286).*

Whereas liberal writers generally view the pursuit of power and wealth, that is, the choice between "guns and butter," as involving a tradeoff, nationalists tend to regard the two goals as being complementary.

Economic nationalists stress the role of economic factors in international relations and view the struggle among states-capitalist, socialist, or whatever-for economic resources as pervasive and indeed inherent in the nature of the international system itself. As one writer has put it, since economic resources are necessary for national power, every conflict is at once both economic and political. States, at least over the long run, simultaneously pursue wealth and national power.

As it evolved in the early modern era, economic nationalism responded to and reflected the political, economic, and military developments of the sixteenth, seventeenth and eighteenth centuries; emergence of strong national states in constant competition, the rise of a middle class devoted at first to commerce and increasingly to manufacturing, and the quickening pace of economic activities due to changes within Europe and the discovery of the "New-World" and its resources. The evolution of a monetarized market economy and the wide range of changes in the nature of warfare that have been characterized as the “Military Revolution” were also critically important. Nationalists or “mercantilists,” (as they were then called) had good cause to identify a favorable balance of trade with national security.

For several reasons, the foremost objective of nationalists is industrialization. In the first place, nationalists believe that industry has spillover effects (externalities) throughout the economy and leads to its overall development. Second, they associate the possession of industry with economic self-sufficiency and political autonomy. Third, and most important, industry is prized because it is the basis for military power and central to national security in the modern world. In almost every society, including liberal ones, governments pursue policies favorable to industrial development. As Alexander Hamilton, wrote: “not only the wealth but the independence and security of a country appear to be materially connected to the prosperity of manufactures. This nationalist objective of industrialization is itself a major source of economic conflict.

Economic nationalism, both in the early modern era and today, arises in part from the tendency of markets to concentrate wealth and to establish dependency or power relations between the strong and the weak economies. In its more benign or defensive form it attempts to protect the economy against untoward external economic and political forces. Defensive economic nationalism frequently exists in less developed economies or in those advanced economies that have begun to decline; such governments pursue protectionist and related policies to protect their nascent or declining industries and to safeguard domestic interests. In its more malevolent form, economic nationalism is the conduct of economic warfare. This type is most prevalent in expanding powers. The classic example is Nazi Germany.

In a world of competing states, the nationalist considers relative gain to be more important than mutual gain. Thus nations continually try to change the rules or regimes governing international economic relations in order to benefit themselves disproportionately with respect to other economic powers. As Adam Smith shrewdly pointed out, everyone wants to be a monopolist and will attempt to be one unless prevented by competitors. Therefore, a liberal international economy cannot develop unless it is supported by the dominant economic states whose own interests are consistent with its preservation.

Whereas liberals stress the mutual benefits of international commerce, nationalists as well as Marxists regard these relations as basically conflictual. Although this does not rule out international economic cooperation and the pursuit of liberal policies, economic interdependence is never symmetrical; indeed, it constitutes a source of continuous conflict and insecurity. Nationalist writers from Alexander Hamilton to contemporary dependency theorists thus emphasize national self-sufficiency rather than economic interdependence.

Economic nationalism has taken several different forms in the modern world. Responding to the commercial Revolution and the expansion of international trade throughout the early period, classical or financial mercantilism emphasized the promotion of trade and a balance of payments surplus. Following the industrial Revolution, industrial mercantilists like Hamilton and List stressed the supremacy of industry and manufacturing over agriculture. Following the first and Second World Wars these earlier concerns have been joined by a powerful commitment to the primacy of domestic welfare and the welfare state. In the last decades of this century, the increasing importance of advanced technology, the desire for national control over the "commanding heights" of the modern economy, and the advent of what might best be called "policy competitiveness" have become the distinctive features of contemporary mercantilism. In all ages, however, the desire for power and independence has been the overriding concern of economic nationalists.

Section Three: Marxism

✪ Section overview

Marxism, which appeared in the mid-nineteenth century as a reaction against liberalism and classical economics, holds that economics drives politics. Political conflict arises from struggle among classes over the distribution of wealth. Hence, political conflict will cease to exist with the elimination of the market and of a society of classes. Since both nationalism and Marxism in the modern era have developed largely in reaction to the tenets of liberal economics, our discussion and evaluation of these ideologies will begin with economic liberalism.

3. 1 The Marxist Perspective

? Dear learner, what do you understand by the Marxist perspective of IPE?

Like Liberalism and Nationalism Marxism evolved in significant variations on the basis of the ideas that were set forth by Karl Marx and Friedrich Engels in the middle of the nineteenth century. Marx's own thinking changed during his lifetime, and his theories have always been subject to conflicting interpretations. Although Marx viewed capitalism as a global economy, he did not develop a systematic set of ideas on international relations; this responsibility fell upon the succeeding generation of Marxist writers.

As in liberalism and nationalism, two basic strands can be discerned in modern Marxism. The first is the evolutionary Marxism of social democracy associated with Eduard Bernstein and Karl Kautsky; in the contemporary world it has tapered off and is hardly distinguishable from the egalitarian form of liberalism. At the other extreme is the revolutionary Marxism of Lenin

As Robert Heilbroner (1980) has argued, despite the existence of these different Marxism's, four essential elements can be found in the overall corpus of Marxist writings. The first element is the dialectical approach to knowledge and society that defines the nature of reality as dynamic and conflictual; social disequilibria and consequent change are due to the class struggle and the working out of contradictions inherent in social and political phenomena. There is, according to Marxists, no inherent social harmony or return to equilibrium as liberals believe. The second element is a materialist approach to history; the development of productive forces and economic activities is central to historical change and operates through the class struggle over distribution of the social product. The third is a general view of capitalist development; the capitalist mode of production and its destiny are governed by a set of "economic laws of motion of modern society." The fourth is a normative commitment to socialism; all Marxists believe that a socialist society is both the necessary and desirable end of historical development. It is only the third of these beliefs that is of interest here.

Marxism characterizes capitalism as the private ownership of the means of production and the existence of wage labour. It believes that capitalism is driven by capitalists striving for profit and capital accumulation in a competitive market economy. Labour has been disposed and has become a commodity that is subject to the price mechanism. In Marx's view these two key characteristics of capitalism are responsible for its dynamic nature and make it the most productive economic mechanism yet. Although its historic mission is to develop and unify the globe, the very success of capitalism will speed up its passing. The origin, evolution, and eventual demise of the capitalist mode of production are, according to Marx, governed by three inevitable economic laws.

The first law, the law of disproportionality, entails a denial of Say's law, which (in oversimplified terms) holds that supply creates its own demand so that supply and demand will always be, except for brief moments, in balance. Say's law maintains that an equilibrating process makes overproduction impossible in a capitalist or market economy. Marx, like John Maynard Keynes, denied that this tendency toward equilibrium existed and argued that capitalist economies tend to overproduce particular types of goods. There is, Marx argued, an inherent contradiction in capitalism between its capacity to produce goods and the capacity of consumers (wage earners) to purchase those goods so that the constantly recurring disproportionality between production and consumption due to the ‘anarchy’ of the market causes periodic depressions and economic fluctuations. He predicted that these recurring economic crises would become increasingly severe and in time would impel the suffering proletariat to rebel against the system.

The second law propelling the development of a capitalist system, according to Marxism, is the law of the concentration (or accumulation) of capital. The motive force of capitalism is the drive for profits and the consequent necessity for the individual capitalist to accumulate and invest. Competition forces the capitalists to increase their efficiency and capital investment or risk extinction. As a result, the evolution of capitalism is toward increasing concentrations of wealth in the hands of the efficient few and the growing impoverishment of the many. With the petite bourgeoisie being pushed down into the swelling ranks of the impoverished proletariat, the reserve army of the unemployed increases, labor’s wages decline, and the capitalist society becomes ripe for social revolution.

The third law of capitalism is that of the falling rate of profit. As capital accumulates and becomes more abundant, the rate of return declines, thereby decreasing the incentive to invest. Although classical liberal economists had recognized this possibility, they believed that a solution could be found through such countervailing devices as the export of capital and manufactured goods and the import of cheap food. Marx, on the other hand, believed that the tendency for profits to decline was inescapable. As the pressure of competition forces capitalists to increase efficiency and productivity through investment in new labor- saving and more productive technology, the level of unemployment will increase and the rate of profit or surplus value will decrease. Capitalists will thereby lose their incentive to invest in productive ventures and to create employment. This will result in economic stagnation, increasing unemployment, and the “immiserization” of the proletariat. In time, the ever-increasing intensity and depth of the business cycle will cause the workers to rebel and destroy the capitalist economic system.

The core of the Marxist critique of capitalism is that although the individual capitalists is rational (as liberals assume), the capitalist system itself is irrational. The competitive market necessitates that the individual capitalist must save, invest, and accumulate. If the desire for profits is the fuel of capitalism, then investment is the motor and accumulation is the result. In the aggregate, however, this accumulating capital of individual capitalists leads to the periodic overproduction of goods, surplus capital, and the disappearance of investment incentives. In time, the increasing severity of the downturns in the business cycle and the long-term trend toward economic stagnation will cause the proletariat to overthrow the system through revolutionary violence. Thus, the inherent contradiction of capitalism is that, with capital accumulation, capitalism sows the seeds of its own destruction and is replaced by the socialist economic system.

Marx believed that in the mid-nineteenth century, the maturing of capitalism in Europe and the drawing of the global periphery into the market economy had set the stage for the proletarian revolution and the end of the capitalist economy. When this did not happen, Marx's followers, such as Rudolf Hilferding and Rosa Luxemburg, became concerned over the continuing vitality of capitalism and its refusal to disappear. The strength of nationalism, the economic successes of capitalism, and the advent of imperialism led to a metamorphosis of Marxist though that culminated in Lenin's Imperialism, first published in 1917. Written against the backdrop of the First World War and drawing heavily upon the writings of other Marxists, imperialism was both a polemic against his ideological enemies and a synthesis of Marxist critiques of a capitalist world economy. In staking out his own position, Lenin in effect converted Marxism from essentially a theory of domestic economy to a theory of international political relations among capitalist states.

Lenin set himself the task of accounting for the fact that nationalism had triumphed over proletarian internationalism at the outbreak of the First World War and thereby to provide the intellectual foundation for the reunification of the international communist movement under his leadership. He wanted to show why the socialist parties of the several European powers especially the German Social Democrats under Karl Kautsky, had supported their respective bourgeoisies. He also tried to explain why the impoverishment of the proletariat had not taken place as Marx had predicted, and instead wages were rising and workers were becoming trade unionists.

In the years between Marx and Lenin, capitalism had experienced a profound transformation. Marx had written about a capitalism largely confined to Western Europe, a closed economy in which the growth impulse would one day cease as it collided with various constraints. Between 1870 and 1914, however, capitalism had become a vibrant, technological, and open system. In Marx's day, the primary nexus of the slowly developing world economy was trade. After 1870, however, the massive export of capital by Britain and subsequently by other developed economies had significantly changed the world economy; foreign investment and international finance had profoundly altered the economic and political relations among societies. Furthermore, Marx's capitalism had been composed mainly of small, competitive, industrial firms. By the time of Lenin, however, capitalist economies were dominated by immense industrial combines that in turn, according to Lenin, were controlled by the great banking houses (but finance). For Lenin, the control of capital by capital, that is, of industrial capital by financial capital, represented the pristine and highest stage of capitalist development.

Capitalism, he argued, had escaped its three laws of motion through overseas imperialism. The acquisition of colonies had enabled the capitalist economies to dispose of their unconsumed goods, to acquire cheap resources, and to vent their surplus capital. The exploitation of these colonies further provided an economic surplus capital. The exploitation of these colonies further provided an economic surplus with which the capitalists could buy off the leadership ("labor aristocracy") of their own proletariat. Colonial imperialism, he argued, had become a necessary feature of advanced capitalism. As its productive forces developed and matured, a capitalist economy had to expand abroad, capture colonies, or else suffer economic stagnation and internal revolutions. Lenin identified this necessary expansion as the cause of the eventual destruction of the international capitalist system.

The essence of Lenin's argument is that a capitalist international economy does develop the world, but does not develop it evenly. Individual capitalist economies grow at different rates and this differential growth of national power is ultimately responsible for imperialism, war, and international political change. Responding to Kautsky's argument that capitalists were too rational to fight over colonies and would ally themselves in the joint exploitation of colonial peoples (the doctrine of "ultra-imperialism"), Lenin stated that this was impossible because of what has become known as the "law of uneven development".

This question (of the possibility of capitalist alliances to be more than temporary and free from conflict) need only be stated clearly enough to make it impossible for any other reply to be given than that in the negative; for there can be no other conceivable basis under capitalism for the division of spheres of influence…. Than a calculation of the strength of the participants in the division, their general economic, financial, military strength of the participants in the division, their general economic, financial, military strength, etc. and the strength of these participants in the division does not change to an equal degree, for under capitalism the development of different undertakings, trusts, branches of industry, or countries cannot be even. Half a century ago, Germany was a miserable, insignificant country, as far as its capitalist strength was concerned, compared with the strength of England at the time. Japan was similarly insignificant compared to Russia. It is inconceivable that in ten or twenty years the relative strength of the imperialist powers will have remained unchanged? Absolutely inconceivable (Lenin, 1939 1i917), p.119).

In effect, in this passage and in his overall attempt to prove that an international capitalist system was inherently unstable, Lenin added a fourth law to the original three Marxist laws of capitalism. The law is that, as capitalist economies mature, as capital accumulates, and as profit rates fall, the capitalist economies are compelled to seize colonies and create dependencies to serve as markets, investment outlets, and sources of food and raw materials. In competition with one another, they divide up the colonial world in accordance with their relative strengths. Thus, the most advanced capitalist economy, namely Great Britain, had appropriated the largest share of colonies. As other capitalist economies advance, however, they sought a re-division of colonies. This imperialist conflict inevitably led to armed conflict among the rising and declining imperial powers. The First World War, according to this analysis, was a war of territorial re-division between a declining Great Britain and other rising capitalist powers. Such wars of colonial division and re-division would continue, he argued, until the industrializing colonies and the proletariat of the capitalist countries revolted against the system.

Lenin's internationalization of Marxist theory represented a subtle but significant reformulation. In Marx's critique of capitalism, the causes of its downfall were economic capitalism would fail for economic reasons as the proletariat revolted against its impoverishment. Furthermore Marx had defined the actors in this drama as social classes. Lenin, however, substituted a political critique of capitalism in which the principal actors in effect became competing mercantilist nation-states driven by economic necessity. Although international capitalism was economically successful, Lenin argued that it was politically unstable and constituted a war-system. The workers or the labor aristocracy in the developed capitalist countries temporarily would pay for these economic gains on the battlefield. Lenin believed that the inherent contradiction of capitalism resided in the consequent struggle of nations rather than in the class struggle. Capitalism would end due to its inherent bellicosity and political consequences.

In summary, Lenin argued the inherent contradictions of capitalism is that it develops the world and plants the political seeds of its own destruction as it diffuses technology, industry, and military power. It creates foreign competitors with lower wages and standards of living who can out-compete the previously dominant economy on the battlefield of world markets. Intensification of economic and political conflicts between declining and rising capitalist powers leads to economic conflicts, imperial rivalries, and eventually war. He asserted that this had been the fate of the British- centered liberal world economy of the nineteenth century. Today he would undoubtedly argue that, as the U.S. economy declines, a similar fate threatens the twentieth- century liberal world economy, centered in the United States.

With the triumph of Bolshevism in the Soviet Union, Lenin's theory of capitalist imperialism became the orthodox Marxist theory of international political economy, yet other heirs of Marxist tradition have continued to challenge this orthodoxy. It has also been modified by subsequent changes in the nature of capitalism and other historical developments. Welfare-state capitalism has carried out many of the reforms that Lenin believed to be impossible, the political control of colonies is no longer regarded by Marxists as a necessary feature of imperialism, the finance capitalist of Lenin's era has been partially displaced by the multinational corporation of our own, the view that capitalist imperialism develops the less developed countries has been changed to the argument that it under develops them, and some Marxists have been so bold as to apply Marxist theory to Lenin's own political creation, the soviet union. Thus modified, at the end of the twentieth century Marxism in its various manifestations continues to exercise a powerful influence as one of the three dominant perspectives on political economy.

UNIT SUMMARY

The forgone analysis of economic ideologies leads to three general propositions. The first is the global distribution of economic activities, especially industry and technology is a central concern of modern statecraft; behind the technical discussion of trade, foreign directed investment and monetary affairs which we are going to discuss in the next chapter are conflicting ambitions and the fundamental question of who is to produce what and where. The second point is that the international division of labour is a product of both national policies and relative efficiency. And due to this changes and uneven growth and national economies, the inherent stability of the international market is highly problematic. It is the nature of the dynamics this system that it erodes the political foundation up on which it must ultimately rest and thereby raises the crucial question of leadership to ensure survival of a liberal international order.

Since the mid-1980s, the relevance of these perspectives has changed dramatically. With the end of both communism and the "import-substitution" strategies of many less developed countries (LDCs), the relevance of Marxism greatly declined, and liberalism, at least for the moment, has experienced a considerable growth in influence. Around the world, more and more countries are accepting liberal principles as they open their economies to imports and foreign investment, scale down the role of the state in the economy, and shift to export-led growth strategies.

Marxism as a doctrine of how to manage an economy has been thoroughly discredited, so that only a few impoverished countries such as Fidel Castro's Cuba and Kim JongIl's North Korea cling to this once strong faith. Yet, Marxism survives as an analytic tool and a critique of capitalism, and it will continue to survive as long as those flaws of the capitalist system emphasized by Marx and his followers remain: the "boom and bust" cycle of capitalist evolution, widespread poverty side by side with great wealth, and the intense rivalries of capitalist economies over market share. Whether under the guise of Marxism itself or some other label concerns over these problems will surface in discussions of the world economy.

UNIT THREE: Components of IPE

✪ Unit Introduction

Dear distance learner welcome to the third unit of IPE. IPE is a network of bargains between and among states and markets. The institutions, arrangements, and the rules of the game that govern the behaviour of states and markets in the international political economy can be analyzed as set of structures which together produce, exchange, and distribute wealth. It is useful to think about structures as networks, bargains and linkages that connect individuals and states and form international systems and through which relational power is exercised. IPE can be analyzed form four different but interrelated international structures, namely: the security structure, the production structure, the financial structure and the knowledge structure.

In this unit an attempt will be made to introduce you to some, not all, of these important structures. This unit is roughly divided in to four sections. The first section will be devoted to the discussion of important terminologies in international trade, finance and monetary relations. In the second section we will discuss about the political economy of trade. The third sections will be devoted to the discussion of the political economy of international monetary and financial relations. In the last section we will discuss about MNC and foreign directed investment (FDI).

Section one: Basic terminologies

✪ Section overview

Dear distance welcome to the first section of chapter three. In this section the focus will be on the definition of some of the most important terminologies frequently used in the discussion of international trade, finance and monetary relations. This is to enable you to be acquainted with some of the most important vocabularies of international trade and finance.

1.1 Terms of Trade (ToT)

? Dear distance learner, what do you understand by the terms of trade?

Terms of trade refers to the value of a nation's exported goods relative to the value of goods that are imported. It is a measure of prices paid for import relative to the price received from exports.

1.2 Balance of Payment (BoP)

? What is the difference between balance of trade and balance of payment?

Balance of payment is a tabulation of all international transactions involving a nation in a given year measured in current dollars ($). In simple terms the BoP measures the inflows and the outflows of money from one nation to other nations. Each international transaction involves both substance and shadow which gives BoP a dual importance. The substance refers to the goods, services and ownership claims that move from country to country- are what really count. They are too hard to quantify in themselves and pretty much impossible to add-up in their natural state. So, the BoP records the shadows-the equal and opposite money movements- the real resource transfer. The BoP is a best indicator of the nation's economic status. The most important parts of BoP are the Current Account and Capital Account.

1.3 Current Account

? What about the current account?

Current account is a part of a nation's BoP that records financial flows due to international trade in goods and services and unilateral transfers (aids or gifts between nations). It measures the way international transactions affect national income. A **Current Account deficit** means the nation is paying out more for goods and services than it receives for goods and services it sells on the international market. Current account also includes *Balance of Trade.*

1.4 Balance of Trade (BoT)

Balance of trade is part of the current account which measures the dollar value of payments in receipts for goods and services. BoT usually gets a lot of attention in ordinary circles as an indicator of the nature of international competition. However, it is an incomplete measure of the impact of international transactions on the economy since it does not take into account payments and receipts of investment income and unilateral transfers. The current account which includes all these items in addition to those in BoT is a better indicator of international economic relations impact a nation.

1.5 Capital Account

Capital account is the part of BoP that records international borrowing, lending and investment. It is a receipt of foreign private and lending and investment in excess of repayment in of principal and interest on former loans and investments. It measures the impact of international transactions on a nation's wealth. If a nation has a capital account surplus, it means that it is net debtor during a particular period.

Section Two: International Trade

✪ Section Overview

Dear learner welcome to the second section of chapter three. This section deals with International trade, which is one of IPE's oldest and most controversial subjects. Many IPE theorists are of the opinion that no topic is more quintessentially IPE than trade. And, it is no surprise that for hundreds of years the time and talents of IPE scholars and practitioners focused on trade issues. This section is divided in two five subsections. In the first sub section we will define international trade. This will be followed by a discussion as why nations trade in the second part. The third and fourth parts of this section are devoted to the discussion of the debate on free trade versus protectionism and instruments of trade policy respectively.

2.1 What Is International Trade

? Dear learner, what do you think is international trade?

International trade is the inter-country flow of goods and financial resources. It is considered to be part of the production structure (a set of relationships that determine what is produced, where, by whom, how, for whom and at what price) of political economy. When elements of this structure cross international boundaries the result is international trade, which assumes forms of interaction between states and other actors such as international business.

Trade is always political and the economics of trade cannot be separated from its political aspect. Not only does trade continue to gain an importance for national officials but also a number political actors and institutions outside the nation states that shape developments in this area has grown significantly since the end of the Cold War. Trade ties countries together and in so doing generates a good deal of political and economic interdependence. Partly because of this, states, today, are compelled more than ever to regulate international trade so as to capture its benefits and limit its costs to their economies.

2.2 Why States Trade?

2.2.1 The Absolute Advantage (Adam Smith Model)

? Dear learner, what do you think is the theory of absolute advantage?

Adam Smith (father of liberalism and economical science) brought the argument in his book "The Wealth of Nations", published in 1776, about absolute advantage. Adam Smith's theory starts with the idea that export is profitable if you can import goods that could satisfy better the necessities of consumers instead of producing them on the internal market. The *essence* of Adam Smith theory is that the rule that leads the exchanges from any market, internal or external, is to determine the value of goods by measuring the *labour* incorporated in them.

In order to demonstrate his theory, Adam Smith analyzed using one country (say A), using one factor of production, the productivity of labour (evaluated in the necessary of hours needed to produce a unit of measure of the products X and Y). Because all the economies have limited resources, there are limits in the level of production, and if a country wants to produce much of one product it has to give up producing another goods, existing in this case renounce of trade.

COUNTRY	PRODUCTS units of product/units of time			
	WITHOUT TRADE		AFTER SPECIALIZATION AND TRADE	
	X	Y	X	Y
A	6	3	12	-
B	3	6	-	12
TOTAL	9	9	12	12

Country A is more productive than B in the production of X and it has an absolute advantage in this product and country B is more productive in producing product Y. It is reasonable and in the benefit of the two countries to concentrate all resources of labour to the product for which they have an absolute advantage. After specialization, exchanging products, both countries can gain from trade.

2.2.2 The Comparative Advantage (David Ricardo model)

? Dear learner, what do you think is the difference between Smith's and Ricardo's theory?

The main distinguishing feature of international trade singled out by Ricardo was the international immobility of factors of production. Factors were regarded as perfectly mobile within countries and completely immobile among countries, whereas goods were perfectly mobile within and among countries (at zero transport cost). Ricardo rather glossed over the question of the interdependence of industries, treating them as integrated, producing one output and using one primary input (labor). The latter being mobile internally, the unit cost of each good was constant, depending only on the amount of labor required to produce it.

In his celebrated example of trade in cloth and wine between England and Portugal, he says "England may be so circumstanced, that to produce the cloth may require the labour of 100 men for one year; and if she attempts to make the wine, it might re-quire the labour of 120 men for the same time. England would therefore find it her interest to import wine, and to purchase it by the exportation of cloth."

COUNTRY	PRODUCTIVITY hours/monetary units		Opportunity cost	
	X	Y	X	Y
A	1	2	0.5	2.0
B	6	3	2.0	0.5

Country A is more productive in X than Y. and country B is more productive in Y than in X. each country should specialize in the production in which it has less opportunity cost.

2.2.3 Mill's Law of International Value

? Dear learner, how does Mill improve Ricardo's theory?

In his remarkable essay, "On the Laws of Interchange between Nations", Mill set out to find a precise solution to the problem left open by Ricardo. It was implicit in his discussion that an intermediate price ratio would necessitate complete specialization, entailing a fixed supply of each good.

The problem was then whether there would exist a price ratio for which "the demand shall be exactly sufficient to carry off the supply". He recognized the possibility of "an extreme case" in which demand might be so rigid that no such intermediate price ratio would exist; in that case, the equilibrium price ratio would have to correspond to one of the limiting cost ratios, and there would be partial specialization in the corresponding country

2.2.4 THE H-O MODEL

? Dear learner, what do you understand by factor endowments?

One of the most popular model advanced in explaining the concept of comparative advantage was provided by two Swedish economists Eli Heckscher and Bertil Ohlin is known as the Heckscher-Ohlin model or the factor endowments or factor proportions model. Since its development in the early 1930s this model has been accepted as the standard explanation of international trade.

Heckscher-Ohlin (or H-O) model of comparative costs or advantage postulates that a country will specialize in the production and export of those products in which it has a cost advantage over other countries. This model suggests that a country will have a comparative advantage in, and therefore will tend to export, those goods whose production requires the intensive use of a factor of production with which that country is well endowed. This theory implies that:

(1) A country will export those products that are intensive in its abundant factor; that is, a capital-rich country will export capital- intensive goods.

(2) Trade will benefit the owners of locally abundant factors and harm owners of the scarce factors. Thus, although all countries will benefit in absolute terms, there will be important distributive consequences that will favor either capital or labor in trading countries.

(3) Trade in factors (capital or labor) and trade in goods will have the same effect and can fully substitute for one another.

(4) Under certain circumstances, trade in goods will over time equalize the return (wages to labor and profits to capital) for each factor of production.

The basic problem with the H-O model or theory is that actual trading patterns frequently differ from what the theory predicts. A notable example is found in intra-industry trade among countries with similar factor endowments. Indeed, most trade among industrialized countries takes place largely in the same product sectors; for example, the United States both exports to and imports from other industrialized countries.

Another important intellectual development that has undermined the H-O theory of international trade is a shift among economists from emphasizing "comparative" to emphasizing "competitive" advantage, especially in high-tech sectors. International competitiveness and trade patterns frequently result from arbitrary specialization based on increasing returns rather than from efforts to take advantage of fundamental national differences in resources or factor endowment. This new thinking about the arbitrary or accidental nature of international specialization and competitiveness emphasizes the increasing importance of technology in determining trade patterns.

Mainstream economists have been hesitant to acknowledge the increased importance of such factors as technology and learning by doing in the determination of trade patterns. Nevertheless, the fundamental idea that comparative or competitive advantage is largely arbitrary and a product of human intervention rather than a fixed gift of nature is accepted by growing numbers of mainstream economists.

Some economists regard actual trade patterns as resulting from many factors other than natural endowments, factors including historical accidents, government policies, and cumulative causation. Moreover, the standard H-O theory itself has been modified and expanded to include such important factors as human capital (skilled labor), "learning by doing," technological innovation, and especially economies of scale. Revisions have so transformed the original H-O model that some economists now argue that the theory of international trade is not much more than an eclectic enumeration of the many factors that determine comparative advantage and trade flows.

However, it is very difficult to incorporate these newly recognized factors into a formal model, and because there is no satisfactory alternative model, economists continue to support the standard H-O theory of trade based on factor endowments. As Richard Caves and Ronald Jones have argued, the Heckscher-Ohlin theory, with its emphasis on factor endowments, is still largely valid. Moreover, as economists argue national specialization and the benefits of a territorial division of labor remain valid concepts that are of overwhelming importance for the efficient use of the world's scarce resources. True! But this generalization does not explain or determine which country will produce what, and nation-states will always be very reluctant to leave that decision entirely up to the market.

These important considerations that "international comparative advantage in the production of and sale of high-technology goods must be struggled for and earned through superior technological innovativeness" has significantly intensified what F. M. Scherer has labeled "international high-technological competition." The drive for technological superiority has notably increased the receptivity of governments to the "new trade theory."

2.2.5 New Trade Theory

? Dear learner, what do you think is the weakness of the H-O model?

The most important and certainly the most controversial development challenging the conventional theory of international trade is the "new trade theory," more commonly known as "strategic trade theory" (STT).

Strategic trade theory is the culmination of earlier challenges to conventional trade theory because it incorporates a growing appreciation of imperfect competition, economies of scale, economies of scope, learning by doing, the importance of R & D, and the role of technological spillovers. STT is significant because it challenges the theoretical foundations of the economics profession's unequivocal commitment to free trade. In fact, STT originated with the development of new analytical tools and growing dissatisfaction with conventional trade theory and its inability to explain the increasing trade problems of the United States, especially with respect to Japan in the 1980s.

Before we consider the theory, however, we will discuss oligopolistic competition briefly. Under conditions of perfect competition, strategic behavior is not possible because the behavior of one or just a few firms cannot significantly change market conditions for other firms. However, if unit costs in certain industries do continue to fall as output increases (economies of scale), the total output of firms will expand but the number of firms will decrease. Economies of scale in an industry mean that the market will support only one or just a few large firms; that is, the industry will become oligopolistic, and the market will eventually be dominated by a few firms. This would permit the behavior of one firm to make a difference and to alter the decisions of other firms. If imperfect or oligopolistic competition exists, then monopoly rents or abnormally high profits can exist in that economic sector; the resultant rents or super-profits could then be captured by a small number of firms or even by one firm. Individual firms, then, may well pursue corporate strategies to increase their profits or economic rents.

Oligopolistic firms can and do consciously choose a course of action that anticipates the behavior of their competitors. If successful, such action enables them to capture a much larger share of the market than would be the case under conditions of perfect competition. For example, oligopolistic firms can and do follow strategies in which they adjust their own prices and output in order to alter the prices and output of competitor firms. Two of the most important strategies used to increase a firm's long-term domination of an oligopolistic market are *dumping* (selling below cost to drive out competitors in the product area) and *preemption* (through huge investment in productive capacity to deter other entrants into the market).

Imperfect or oligopolistic competition is most likely found in certain high-tech industries characterized by economies of scale and learning by doing. The sectors most likely to become oligopolistic include computers, semiconductors, and biotechnology; these technologies, of course, are identified by most governments as the "commanding heights" of the information economy. Many are dual technologies, because they are very important to both military weaponry and to economic competitiveness. Many countries consider it essential for both commercial and security reasons to take actions that will ensure a strong presence in some or all of these sectors. The importance of a head start in these industries encourages firms to pursue a "first-mover" strategy so that cumulative processes and path dependence will strengthen their market position.

The theory of strategic trade takes the existence of imperfect or oligopolistic competition one step further and suggests that a government can take specific actions to help its own oligopolistic firms. Government policies can assist national firms to generate *positive externalities* (e.g., technological spillovers) and to *shift profits* from foreign firms to national firms. Economists have long appreciated that a nation with sufficient market power could enact an optimum tariff and thereby shift the terms of trade in its favor. By restricting imports and decreasing the demand for a product, a large economy may be able to cause the price of the imported good to fall. Strategic trade theory, however, goes much farther than optimum trade theory in recognizing the capacity of a nation to intervene effectively in trade matters and thus to gain disproportionately.

A government's decision to support a domestic firm's plans to increase its productive capabilities (preemption) or even to signal intention to build excess productive capacity exemplifies a strategic trade policy. Through use of a direct subsidy to a firm or outright protection of a domestic industry, the government might deter foreign firms from entering a particular industrial sector. Since a minimum scale of production is necessary to achieve efficiency, especially in many high-tech industries, the advantage of being first ("first-mover advantage") encourages a strategy of preemptive investment.

Strategic trade theory departs from conventional trade theory in its assumption that certain economic sectors are more important than others for the overall economy and therefore warrant government support. Manufacturing industries, for example, are considered more valuable than service industries because manufacturing has traditionally been characterized by higher rates of productivity growth and has produced higher profits, higher value-added, and higher wages.

Some economic sectors, especially such high-tech industries as computers, semiconductors, and information processing, are particularly important because they generate spillovers and positive externalities that benefit the entire economy. Because a new technology in one sector may have indirect benefits for firms in another sector, firms that do extensive research and development are valuable to many others.

However, because firms may not be able to capture or appropriate the results of their research and development activities, many will under-invest in these activities. Proponents of strategic trade theory argue that such a market failure indicates that firms should be assisted through direct subsidy or import protection, particularly in high-tech industries, which frequently raise the skill level of the labor force and thus increase human capital. If, as the proponents of strategic trade believe, such special industries do exist, then free trade is not optimal, and government intervention in trade matters can increase national welfare.

Strategic trade theory has become a highly controversial subject within the economics profession. Some critics argue that strategic trade theory is a clever, flawed, and pernicious idea that gives aid and comfort to proponents of trade protectionism. Other opponents of the theory agree with this negative assessment and maintain that the theory itself adds nothing really new to dubious arguments favoring trade protection. Perhaps in response to the severe denunciations of strategic trade theory by leading mainstream economists, some of its earliest and strongest proponents have moderated their initial enthusiasm.

2.3 Perspectives in International Trade: Free Trade versus Protectionism

? Dear learner, should states protect their industries from external competition?

The different perspectives on IPE provide different motivations for trade to take place. The system of international trade pulls in three directions at once. There is a large but far from universal consensus that a liberal international trading system is desirable. Within that liberal structure, however, individual nation states try to pursue mercantilist policies while worrying about becoming dependent and being exploited by other nations. Thus, it is possible for national leaders apparently to believe in all three perspectives at once: a global system of free trade (liberal), but protection for domestic firms and workers (mercantilist) by promoting high wage or high technology industrialization (structuralist). No wonder, international trade policy is so controversial. In the coming sections, an attempt will be made to shade light on the three perspectives of international political economy and their respective positions on international trade.

As noted in the foregone sections one of the significant perspective on international trade is liberalism, formalized through the theory of absolute / comparative advantage by Adam Smith and David Ricardo.

The liberal doctrine of free trade is based on the principles of the market system formulated by classical economists. Adam Smith and David Ricardo argued that removing the impediments to the free movement of goods would permit national specialization and facilitate optimal utilization of the world's scarce resources. Trade liberalization would lead to efficient trade patterns determined by the principle of comparative advantage; that is, by relative factor prices (of land, capital, and labor). Adoption of the principle of "comparative advantage" or "comparative cost" would ensure that a country would achieve greater economic welfare through participation in foreign trade than through trade protection. Underlying this liberal commitment to free trade is the belief that the purpose of economic activity is to benefit the consumer and maximize global wealth. Free trade also maximizes consumer choice, reduces prices, and facilitates efficient use of the world's scarce resources. From this perspective, the primary purpose of exports is to pay for imports rather than to enhance the power of the state.

According to its advocates, trade liberalization produces a number of specific benefits. In the first place, trade liberalization increases competition in domestic markets, and thereby undermines anticompetitive practices, lowers prices, increases consumer choice, and increases national efficiency. In addition, free trade increases both national and global wealth by enabling countries to specialize and to export those goods and services in which they have a comparative advantage while importing those goods and services in which they lack comparative advantage. Free trade also encourages the international spread of technology and know-how around the globe and thus provides developing economies with the opportunity to catch up in income and productivity with more advanced economies. Last, but not least, free trade and the international cooperation that it entails increase the prospects of world peace. Trade protection also has a negative impact on income distribution. A tariff or other restrictive measure creates economic or monopoly rents and shifts income from consumers and non-protected sectors to the protected sectors of the. Finally, one of the most serious dangers of trade restrictions is that they tend to protect declining noncompetitive industries.

The one important exception to economists' universal belief in the superiority of free trade over trade protection is the protection of infant industries. Many economists accept the argument first set forth by Alexander Hamilton (a mercantilist) that nourishing infant industries can provide an acceptable rationale for trade protection. An infant industry is one that, if protected from international competition, will become sufficiently strong and competitive to enable it to survive when protection is eventually removed. A major problem with infant industry protection, however, is that protection too frequently becomes permanent.

From eighteenth-century mercantilists to present-day protectionists, advocates of trade protection have desired to achieve certain political, economic, and other objectives more than the economic benefits for the entire society of free trade. However, the specific objectives sought by protectionists have varied over time and space. Economic nationalists regard trade protection as a tool of state creation and statecraft; for example, a trade surplus is considered beneficial for national security. Many representatives' of less developed countries believe that trade with industrialized countries is a form of imperialism; they fear that free trade benefits only the developed economy and leads to dependence of the less developed countries on the developed ones.

Opponents of free trade in developing economies also include advocates of the "developmental state" who believe that the state rather than free markets should have the principal role in the process of economic development. In developed economies, proponents of trade protection reject free trade and other forms of globalization as threats to jobs, wages, and domestic social welfare; organized labor in industrialized countries increasingly advocates protection against imports from low-wage economies with inadequate labor standards. In recent decades, more and more environmentalists have denounced trade as a threat to the environment.

The most systematic economic rationale for economic nationalism and trade protection was provided by Friedrich List. Strongly influenced by Alexander Hamilton's protectionist ideas, List argued in his *National System of Political Economy* (1841) that every industrial nation has pursued and should pursue protectionist policies in order to safeguard its infant industries. List maintained that once their industries were strong enough to withstand international competition, these countries lowered their trade barriers, proclaimed the virtues of free trade, and then sought to get other countries to lower their barriers. Free trade, List believed, was the policy of the strong. If one were to translate List's ideas into modern parlance, one would say that every successful industrial power at some point in its history has carried out an activist industrial policy.

At the beginning of the twenty-first century, many trade protectionists advocate promotion through national industrial policies of high tech and certain other favored sectors in order to build the nation's industrial strength and increase its competitiveness. They believe that the state should guide and shape the overall industrial and technological structure of the society through trade protection, industrial policy, and other forms of government intervention. In addition to such high tech industries as computers and electronics, economic nationalists also favor support for more traditional manufacturing industries such as the automobile and other mass-production industries characterized by high value-added and high wages. Although in its efforts to catch up with the West, Japan has conspicuously and aggressively pursued an industrial policy, industrial policies have also been employed by the United States, Western Europe, and many developing economies to promote industries believed important for national security and economic development.

Economists have strongly disputed the alleged benefits of trade protection. Trade protection, they point out, reduces both national and international economic efficiency by preventing countries from exporting those goods and services in which they have a comparative advantage and from importing those goods and services in which they lack comparative advantage. Protection also decreases the incentive of firms to innovate and thus climb the technological ladder; it also discourages shifting national resources to their most profitable use.

Despite economists' arguments supporting trade liberalization, trade protectionism persists, and its advocates too frequently succeed. Endogenous trade theory explains the success of protectionism by calling attention to the fact that the political process generally favors special interests desiring protection rather than general consumer interests. Whereas the benefits of free trade diffuse across a society, the benefits of protection are concentrated in a few groups of producers.

2.4 Instruments of Trade Policy: Utilization and Impacts

? Dear learner, what do you understand by instruments of trade policy?

Contemporary trade policy is deeply conditioned by all the three IPE perspective on trade. As noted earlier, there seems to be a consensus on the liberal international trade system whose most important justification is contained in the H-O model. However, states tend to behave as mercantilist when national interests are threatened.

2.4.1 Instruments of Trade Policy

(A)Tariffs: a tariff is a tax on an import that is usually a percentage of the price of that import. They are used as a way of raising revenue for the government and can also be used to raise the price of an imported good up to a certain level to prevent foreign competition for domestic producers of that good. There are different kinds of tariffs.

Imports tariffs are usually two kinds:

i. *Specific* tariff: this refers to a monetary sum that must be paid to import physical one unit of a product. The a*dvantage is* it is easy to collect. The d*isadvantage is* it doesn't take price changes into account.
ii. *Ad valorem* tariff: this is a percentage of the monetary value of one unit of import. The a*dvantage it* takes price changes into account. The *Disadvantage is you n*eed to know the monetary value of the good and seller is tempted to undervalue the price.

Other tariff instruments include: import subsidy and export tariff. In the first case, the home government may intentionally encourage some products *via* subsidy that are produced outside the country while discouraging others. That is why it sometimes called *negative import* tariff. On the other hand, *export tariff* or *subsidy* is levied or paid on home-produced goods that are destined for export.

Features of Tariff Schedules

- Preferential duties- products from certain countries are subject to lower tariffs than the normal tariff rate.
- Generalized System of Preferences (GSP) for developing countries
- Most-favoured-nation (**MFN**) treatment, equivalent to what is sometimes called normal trade relations (NTR) "if country A grants country B the status of most favoured nation, it means that B's

exports will face tariff that are no higher (nor lower) than those applied to any other country that A calls a MFN".

(B)Non-tariff Barriers to Trade

There are many forms of non tariff barriers to trade and some of these barriers will be discussed as follows.

Import Quotas: a government agency allocates the rights to import by limiting the number of goods (not the price) for a given time period. It is a limit imposed up on the amount of a particular good that can be imported in to a country. Quotas may be imposed or can be achieved through V*oluntary export restraints* [VER]: foreign suppliers agree to "voluntarily" refrain from sending some exports.

Exchange controls: there are a number of different ways in which to control foreign exchange. These includes limits on the amount of foreign exchange made available to importers or citizens travelling abroad or limits on the amount of foreign exchange to be for investment purposes and also charges made when purchasing foreign currency.

Import licensing: this occurs when importers obtain licenses so that the government can better enforce restrictions.

Embargos: an embargo is imposed when a government decides to completely ban imports or exports to certain country.

Export taxes: these can be used to increase the price of a country's goods when that country has a monopoly on the supply of that good.

Subsidies: subsidies can be imposed on the production of goods made at home for the home market to prevent competition otherwise lower priced foreign goods. Subsidies can also imposed on exports to artificially increase trade (known as dumping).

Domestic content provisions and Administrative barriers- Domestic content provisions require a given percentage of the value of a good must consist of domestic components or labour. *Administrative barriers* may take different forms different Domestic policies affecting trade: health, environment and safety standards; packaging and labeling requirements; inconsistent treatment of intellectual property rights; subsidies to domestic firms, etc.

Section three: International Monetary and Financial Relations

✪ Section overview

International monetary and financial relations are at the center of today's international political economy. Currency values, short- and long-term capital movements, debtor-creditor relations, and related issues are crucial to the private sector, to intergovernmental relations, and to private-public sector interaction around the world. A fundamental analytical and practical question for those concerned about the future of the world economy is indeed the extent to which growing international financial ties will lead toward more cooperation among national policy makers, and among nationally-based businesses, or more conflict among them. This section is your visa to the complex world of international money and finance. The world of international finance and money is so complex that any exhaustive discussion of the issue cannot be accomplished in a book let alone in a couple of pages. What we hope to do is to give you an insight as to their importance in IPE. In the first part we will discuss international monetary relations followed by a discussion on the political economy of finance.

3.1 International Monetary Relations

3.1.1 The Vocabulary of International Money (Exchange Rate)

? Dear distance learner, what do you think is an exchange rate?

Before we go deep in to the discussion of the political economy of international monetary relations, let us first define some of the most frequently used terminologies in international monetary systems. We will begin our discussion with exchange rate. The foreign exchange system organizes the terms and conditions for international payments and set the method for determining the exchange rate between different countries' currencies. Exchange rate refers to the ratio of exchange between the currencies of different countries. At a very general level, the foreign exchange is simply the price of foreign currency which clears the market for foreign exchange, or the rate at which one currency is exchanged for another.

In the contemporary world, a nation's **money** is like a ticket which can be exchanged for goods and services in the country that issues it. The behavior of exchange rate is so vital to any state as it links a country's macro and micro economies to the rest of the world through the asset market and goods market. In macro- economic terms, this happens in two ways. First, in the goods market, the higher the exchange rate, the higher the prices of the imported goods in the home currency will be. For a given level of domestic costs and prices, a higher exchange rare will make foreign goods less attractive to domestic consumers whilst domestic goods will become attractive to consumers in the rest of the world. Second, in the asset market the exchange rate is an important variable when decisions are being made by domestic wealth holders over how that wealth is to be held. Such choices are dependent up on the trade-off between risk and return. The higher the return on foreign assets compared to domestic assets in the home currency- provided there is no increase in the level of risk- the more chance there is that domestic residents will move their wealth in to foreign asset.

In micro-economics terms, the exchange links a country to the rest of the world in ways that are vital to resource allocation. In goods market, when an exchange rate change makes an economy more competitive, the number of tradable goods increases. More goods then become exportable, and fewer goods are imported as a result. On the other hand, when a change in the exchange rate makes an economy less competitive, resources are largely utilized in the domestic market. More goods are imported and fewer exported. Exchange rate changes, therefore, affect the resource allocation in an economy because the distribution of income between different groups or sectors is often dependent up on the level of competitiveness.

The three main types of foreign exchange systems (which will be examined in greater detail in the coming sections) are:

- *Fixed or pegged FX- where FX rate is most heavily influenced by states actions;*
- *Flexible or floating FX- where international FX markets (demand and supply) are the principal determinants of exchange rate and;*
- *Managed or coordinated FX- where states and markets are important determinants*.

Special vocabularies used in discussing changes of FX rate are depreciation and appreciation. When a currency becomes more valuable relative to other currencies it is said to be appreciated and when it becomes less valuable relative to other currencies it is said to be depreciated. While many economic forces affect exchange rate two of the most important are the inflation rate and interest rate. All else being equal, a nation’s currency tends to depreciate when that nations experiences higher inflation rates. Inflation, a rising of overall prices, means that the currency has less real purchasing power within its home country. This makes the currency less attractive to foreign buyers. In the same way, if a nation has lower inflation rate, its currency tends to appreciate reflecting the relatively higher power of its money,

Interest rate also affect exchange rate because they influence the value and desirability of the investment that a particular currency can purchase. For instance lower interest rate can lead to a lower demand for a hard currency making a hard-currency- dominated investment less attractive to foreigners. For borrowers, the rate of interest basically measures the cost of borrowing for investment purposes; the lower the cost of borrowing is, other things being equal the more borrowers will wish to invest. For lenders, the rate of interest measures the rate of return which will be received when their wealth is invested. Consequently, the higher the return, the more wealth those lenders will wish to invest.

3.2 The Political Economy of International Monetary Relations

? Dear distance learner, do you think that international monetary systems are politically neutral?

Although analysts readily acknowledge that international trade and foreign investment have important implications for distribution of wealth and power among nations, no such similar agreement exists regarding the significance of international monetary systems. Many economists believe that money and international monetary systems are economically and politically neutral. However the norms and conventions governing the system have important distributive effects on the power of states and the welfare of groups within the states.

Despite the believe of many economists that the monetary system is a neutral mechanism, every monetary regime imposes differential costs and benefits up on groups and states as it specifies the nature of international money, the instruments of national policy that are acceptable for balance of payments adjustment and the legitimacy of different objectives of national policy. Every state therefore desires not only efficient international monetary systems, but also the one that does not harm it s own interests.

Money has of course always been an important factor in the world of politics. Rulers have acquired money to finance and support their armies, to support their allies, and bribe their enemies. The importance of money in the modern world has multiplied many times and its character has changed profoundly. In fact the enhanced role of international monetary systems in the affairs of the modern states constitutes a virtual revolution in world politics. Its significance can be appreciated through a chronological examination of the changing role of money, economic and political implications of these changes in the international economy.

3.2.1 The Era Of The Specie Money

? Dear distance learner, what do you think was the basis of international exchange before the invention of paper money?

In the pre modern period, precious metals, principally silver, served as a basis of the international monetary system. Local and international trade tended to be separated from each other. Whereas local trade tended to dependent up on barterer locally recognized money, international trade was, served by great currencies minted from gold and silver. Thus the solidus of the Constantine, the dinar of the Arabs or the ducat of the Venice were universally accepted and held their values for centuries. Whether minted in to coin or left in the form of bullion, gold and silver constituted a neutral medium of international exchange; one states gold and silver are as good as the other ones and in effect international currencies enjoyed political and economic autonomy.

The nature and role of the system began to change in the sixteen century with the discovery of gold in the Americas and the expansion of international trade. The separation of local and international money begun to break down as the consequence of great influx in to Europe of precious metals of the new world, the growing monetization of national economies, and the increasing interdependence. In time gold and silver drove out local currencies leading to the increasing intertwining of local and international money and consequently governments were unable to manipulate local economic activities as domestic economic activity and price levels had become subject to international changes.

This has led to the development of the science of economics which subsequently become the basis for the development of the liberal economics. In his *price-specie flow theory*, David Hume responded to the growing obsession of the mercantilist state to accumulate precious metals through a trade surplus and their fear that trade deficit would result in the loss of precious metals. He demonstrated that, if a country gained precious metals in payment for an excess export over imports would cause its domestic and then its export price to rise. This would in turn discourage others from buying its products. At the same time its citizens would be able to import more because of the relative value of it's their currency had risen and foreign prices would fallen because of the decrease money supply abroad. As a result a nation's export would decline and its imports would increase.

Although Hume's price-specie flow mechanism continued to characterize international monetary relations in to the twenty first century, the nature of the monetary system was revolutionized in the modern world due to a number of economic and political reasons. Stated simply money had been transformed from a gift of nature to the creation of a state. State controls over the supply and demand for money become a principal determinant of the level of international and national economic activity. To understand the significance of this transformation, it is first necessary to comprehend what is known as the financial revolution.

During the18th and 19th century sates begun to issues paper money, modern banking arose, and public and private credit instruments proliferated. For the first time in history governments acquired the extensive control over money supply; at least in theory could influence the level of economic activity through the creation of money. The change in the nature of money brought about a serious clash between domestic economic autonomy and international monetary order. And hence bringing with itself the political economy of international monetary relations and the questions of who gets what, when and how. Monetary stability and the efficient operation of the international monetary system require the subordination of domestic policies to international rules and conventions. If individual governments create too much money, the resulting inflation can destabilize international monetary relations. The conflict between domestic economic autonomy and international economic stability has become the fundamental dilemma of monetary relations. The manner in which this dilemma has or has not been resolved defines the phases in history of international monetary relations.

3.2.2 The Classic Gold Standard

? Dear distance learner, have you ever heard of the era of the gold standard?

The international gold standard, which reached its zenith in the late nineteen century, was the classic resolution of the aforementioned dilemma. Gold is a monetary arrangement under which the basic unit of currency of is defined by stated quantity of gold. This monetary system prevailed between 1875 and 1914. Participating countries were committee to fixing the prices of their domestic currencies in terms a specified amount of gold. The countries maintained this fixed prices by being willing to buy and sell gold to anyone at that price. These feature provided a fixed exchange rate mechanism for adjusting the international balance of payments as trade and payment imbalances among nations were brought back in to equilibrium through the flow of gold.

During its reign the classic gold standard provided an effective foundation for the 19th century international and economic order. It was not, however, as liberal economists would like us to believe, an automatic, impersonal and politically symmetrical political order. It was not automatic as banks manipulated the buying and selling of gold in a manner that reduces the effect of the flow of gold on domestic economy. The system did not operate impersonally as it was organized and managed by Britain and the city of London through its hegemonic position in the world commodity, money and capital market, enforced the rules of the system up on world economies. The monetary system was not politically symmetrical in its effects on various economies as the balance of payment adjustment had very different consequences on advanced economies and less developed once.

The clash between domestic autonomy and international order achieved under the gold standard provides an example of a dominant hegemonic power enforcing the rules of the game and managing world economic affairs. As the world's preeminent industrial, trading and capital exporting country in the nineteen century Britain performed this task in an interest of a stable and smoothly functioning international monetary system; as it has the power and the will to do so.

Near the end of the nineteenth century, the rise of the new industrial powers and the relative decline of the British hegemony began to undermine the basis of the British global economic leadership. France, Germany and other nations disliked a monetary order that benefited Britain and most importantly the less developed countries grew frustrated with paying the costs of the adjustment. Raising social discontent and the revolt against laissez faire begun to shake the system. The force of economic inertia, however, continued British dominance in money and finance long after the British dominance in manufacturing vanished. The First World War destroyed the political foundation of this economic era and plunged the world in to monetary and economic chaos for the next three decades.

3.2.3 The Interwar Period (1914-1944)

? Dear distance learner, do you know the major cause of the great depression of the 1930s?

A major consequence of the First World War was the nationalization of the world's monetary system. Upon the outbreak of hostilities, the belligerents acted quickly to safeguard their gold supplies and disengage from the system of fixed exchange rates to facilitate the freeing and mobilization of their economy for war. The gold standard collapsed and its place was taken by a makeshift of arrangement of floating (freely exchangeable) currencies. With the end of British leadership and collapse of economic interdependence, the determination of currency values became the responsibility of national authorities. Domestic economic autonomy triumphed over international monetary order due to the requirements of war.

The implication of the collapse of the international monetary order and the states acquisition of control over domestic activity was viewed differently by economists. On the one hand, those who subscribe to Keynesian economics focused on the opportunity that this transformation provided for the elimination of the evils of the free market such as unemployment, and recession. Through manipulation of few monetary variables like government spending, interest rate and money supply public spirited economics and their science could achieve social justice and economic progress.

On the other hand, conservative liberal economists considered the undisciplined monetary power of the modern state to be an invitation to political irresponsibility because it eliminated economic safeguards against inflation and other evils. They feared that the state would use its new taxing and borrowing powers to shift the distribution of national income from the producer and saver to the non producer. In a world without restraints and the gold standard and other international norms, democratic governments seeking to court popularity and appease special interests through the expansion of costly government programs would subject to ever increasing inflationary pressure; this could undermine both capitalism and democracy.

In the immediate aftermath of the war there was an attempt to return back to the gold standard. However, it survived for just few years and its collapse was the major factor in precipitating the great depression of the 1930s. There were many reasons for the collapse, and these are: first, governments begun to value domestic welfare objectives like full employment and stability than an international monetary order. Second, Britain has no longer the power to manage international monetary order due its industrial decline and the rise of new economic powers.

The ensuing economic chaos led to fragmentation of the international monetary systems in to several competing monetary blocs. At the Ottawa conference in 1932, the British and its trading partners created the sterling bloc. Soon after the dollar bloc was created around the United States and gold bloc around France. Finally Germany, Japan and Italy taking the advantage of the world economic crisis attempted to create autarchic empires. The world economy entered an era of unprecedented economic warfare, with competitive devaluations and fluctuating currencies as each economic bloc attempted to solve its payments and employment problems at the expense of the other.

The event of the interwar period meant the end of an automatic equilibrium that on the whole, characterized the era of gold standard. The simultaneous achievement of internal and external balance through the achievement of Hume's price-specie flow mechanism was decreasingly applicable to a world where central banks tried to counter the effects and prices/wages were not permitted to fall automatically in response to tight monetary policies; the era of government intervention and management of the economy had arrived.

3.2.4 The Bretton Woods System (1944-1976)

? Dear distance learner, what do you understand by the Bretton woods systems?

Following the trauma of the great depression and the scarifies imposed on the citizenry during the Second World War, the western powers established two sets of economic priorities, namely the achievement of economic growth and full employment at the domestic scene and the creation of a stable international economic order that would prevent a return of eh destructive economic nationalism of the 1930s, which is often called the Bretton wood system.

The Bretton wood system had several key features. It envisions a world in which governments could have considerable freedom to pursue national economic objectives, yet the monetary order would be based on fixed exchange rates in order to prevent the destructive competitive depreciation and policies of the 1930s. Another principle adopted was currency convertibility for current account transactions. The international monetary fund was created to supervise the operation of the monetary system and provide medium term lending to countries experiencing temporary balance of payment difficulties. And finally in the event of fundamental disequilibrium the system allowed a nation to change its exchange rate with international consent.

The Bretton woods systems reflected fundamental in social purposes and political objectives. Whereas the nineteen century gold standard and the ideology of laissez faire had subordinated domestic stability to international norms and the interwar period had reversed these objectives, the post regime tried to achieve both. Under this system the American economy became the principal engine world economic growth; American monetary policy became world monetary policy. United sates assumed primarily responsibility for the management of the world monetary systems beginning with the marshal plan. The Federal Reserve became the world's banker and the dollar became the basis of international monetary system. The classic Bretton woods system was quickly replaced by what the French call the dollar hegemony.

Several key elements characterize what in effect become a gold exchange standard based the dollar. As other nations pegged their currency to the dollar, a system of fixed exchange rate; the adjustment process involved simply taking actions that changed the par value of a currency against the dollar. The basis of the system was the pledge of the united to keep the dollar convertible in to gold at $ 35 per ounce and because of this the dollar become the principal medium of exchange, unit of account and store value.

Nevertheless, there was a fundamental contradiction at the heart of this dollar-based system. While the huge outflow of American dollars to finance the rebuilding of Western Europe and Japan and the American military buildup during both the Korean and Vietnam Wars helped solve certain problems, this outflow of dollars meant that the United States would one day be unable to redeem in gold, and at the agreed price of $35 per ounce, those dollars held by private investors and foreign governments. Robert Triffin, in a series of writings, predicted that confidence in the dollar would be undermined as the American balance of payments shifted from a surplus to a deficit. This problem did become acute late in the 1960s when escalation of the Vietnam War and its inflationary consequences caused deterioration in international confidence in the value of the dollar. As that confidence declined, the foundations of the Bretton Woods System of fixed rates began to erode.

Decreased confidence in the dollar also led to intensifying speculation in gold, and this was followed by futile attempts to find ways to recreate confidence in the system. For example, in the late 1960s, Special Drawing Rights (SDRs) were created by the IMF as a new reserve asset, although they were never utilized extensively. However, as Benjamin Cohen has convincingly argued, it was only when a political solution was devised that maintenance of the dominant position of the dollar was ensured. America's Cold War allies, notably Western Europe and Japan, fearing that collapse of the dollar would force the United States to withdraw its forces from overseas and to retreat into political isolation, agreed to continue to hold overvalued dollars. The dollar was also bolstered for a period of time because such export-oriented economies as West Germany and, at a later date, Japan, wanted to retain access to the lucrative American market and therefore supported the high dollar. However, as soaring inflation undercut the value of the dollar, a more fundamental economic solution was needed

3.2.5 The End of Fixed Exchange Rates

? Dear learner, what do you think is the reason for the collapse of the Bretton woods system?

In the early 1970s, the deteriorating position of the dollar became the central issue in the world economy. Escalation of the Vietnam War and the simultaneous launching of the Great Society Program by the Johnson Administration (1963–1969) had caused the global rate of inflation to accelerate and to threaten the value of the dollar. The U.S. government, attempting to hide the financial cost of the Vietnam War from the American people, refused to increase taxes and chose instead to pay for its warfare and welfare policies through inflationary macroeconomic policies. The succeeding Nixon Administration (1969–1974) compounded the problem of inflation. In addition, the Federal Reserve threw caution to the wind as it stimulated the economy, a move that critics labeled a blatant attempt to reelect Nixon. Subsequent intensification of speculative attacks on the overvalued dollar and ballooning of the American trade/payments deficit resulted in the Nixon Administration's decision on August 15, 1971, to force devaluation of the dollar.

The international monetary system was thus changed, at least de facto, from one based on fixed exchange rates to one based on flexible rates. Subsequent efforts of an international committee to develop a new system of stable exchange rates failed. The overwhelming problems posed by increased capital mobility, along with fundamental differences between the United States and Western Europe over any new system, made agreement impossible. Moreover, the huge OPEC monetary surplus following the first oil crisis, and the need to recycle those funds, proved important in the development of the international financial market. Before the end of the 1970s, the scale and velocity of international financial flows had expanded enormously and had truly transformed the international economic system. As a consequence of this impasse, the major industrial powers accepted economic reality at the Jamaica Conference (1976) and instituted flexible rates. This situation was described by some as a "non-system", because there were no generally recognized rules to guide the flexible rates or any other decisions on international monetary affairs.

3.3 International Financial relations

3.3.1 Meaning And Scope

? Dear distance learner, what do you understand by international financial relations?

Financial structure comprises the set of relationships, institutions, and practices that bind together creditors and debtors, borrowers and lenders. These relationships exist within the framework provided by the international monetary system. The finance structure creates a pattern of rights and obligations that conditions the behaviour of nations, businesses and individuals. The finance structure is both local and international in its scope.

International finance is a major force in integrating world economy. Since the period of renaissance and the development of modern banking private capital has nourished the international political economy in the form of loans and portfolio investment (stocks and bonds). In the contemporary period, foreign directed investment by multinational corporations has augmented these traditional means of capital flow. Government and international organizations have also become important sources of capital through the making of loans and official aid particularly to the less developed countries.

From the perspective of liberal economics, the primary function of international finance to transfer accumulated capital to the location where its marginal rate of return is highest and where it can therefore be employed most efficiently. International finance links the international economy and also contributes to its dynamic nature. In a world divided among competitive states, however, international finance has also ahs significant political consequences. It creates dependency relationships and is a major source of national power. Both foreign investment and official aid involve extensive penetration of an economy and in many cases lead to continuing external influence over domestic activities. Although trade and monetary relations may impinge up on an economy, foreign investment, loan and aid have a greater tendency to create superior subordinate relationships. Stockholders and creditors have been known to call up on their own governments to intervene in other societies to protect their investment; foreign investment and international finance have always aroused political and nationalistic passions.

3.3.2 International Finance And Balance Of Payments

? Dear learner, what do you think is the relationships between international finance and BOP?

The set of relationships that form the financial structure bind together those who pay and those who receive. As with other IPE structures the nature of these ties is complex and controversial. The ideas of international finance are built around the concept of Balance of Payment (BoP). Under normal circumstances a surplus in one account must be offset by the deficit in the other. This is the balance in the balance of payments. A nation that has a current account deficit, for example, must either borrow a fund from abroad or sell of its assets to foreign buyers its international bills, thus, achieve an overall payments balance. A current account deficit, therefore, requires a capital account surplus. In the same way, a nation with a current account surplus has excess funds to purchase foreign assets creating a capital account deficit.

Each international transaction involves foreign exchange. And, for foreign exchange market to balance it is necessary for inflows and outflows of a currency to balance. Essentially a nation can continue to experience deficit in the current account as long as it can obtain the necessary funds through a capital account surplus- that is as long as it is able to borrow funds from abroad or to find buyers for its assets. When these assets are exhausted or more realistically when foreign lenders are unwilling to extend additional credit a predictable but unfortunate chain of events set in motion, a balance of payment crisis. Because of the iron logic of the balance of payments, a nation that is unable to borrow (capital account) cannot afford to import (current account). International trade is disrupted and needed imports are often impossible to obtain.

A balance of payment crisis is a bad thing both for the nation that experiences it and for the other nations of the world, since trade and international finance relationships are distorted by such a crisis. It is conceivable that crisis in one nation along with that nation's attempt to deal with its problems could spawn additional problems elsewhere. Economic peril can spread from one nation to another as it did during the Great Depression of the 1930s and the Global Financial Meltdown of 2010. Although a balance of payment crisis is fundamentally an economic problem it quickly translates into political problems since it usually falls to the state and its political leadership to propose and implement the frequently harsh policies that may be necessary to bring international payments back into balance. To prevent international debt calamities the architects of the Post-War Bretton Woods system of international finance sought to provide a lender of last resort, a term that refers to a hegemonic state or international institutions that continue to lend after all others cease in order to provide stability.

3.3.3 The Globalization Of International Finance

? Dear learner, what do we mean by globalization of finance?

Along with the increased levels of trade that have been a characteristics of post WWII period has come the phenomenon of highly mobile capital. This has been aided by the widespread removal of capital controls among industrialized nations and the internationalization of financial and banking practices, such that the amount of financial trade that now takes place far outstrips its goods trade equivalent. Capital flows have grown dramatically since 1980s with net private capital flows growing in significance. There has also been a major shift towards so-called equity financing, in the form of either foreign direct investment or portfolio investment.

There are powerful reasons to study the political economy of international capital movements. Economic theory shows that factor movements are substitutes for international trade, and may even perform similar functions more rapidly. If a labor-rich country maximizes its welfare by exporting labor-intensive and importing capital-intensive goods, it does so even more directly by exporting labor and importing capital; the converse holds for a capital-rich country. Indeed, international capital markets are today the pivot around which the world economy rotates in a way of investment abroad in traditional portfolio and direct forms.

To this end, the future of international financial relations, and especially the degree of conflict involved in them, is a function of both economic and political considerations. A political economy approach to the international financial relations is only in its infancy. We suggest, here, that the starting point for a political economy of international finance should be the relationship between international investment interests and the foreign economic policy preferences they imply.

Section Four: Foreign Directed Investment and MNCs

✪ Section Overview

The importance of the multinational corporation (MNC) is a key feature of globalization of the world economy. However, opinions differ greatly over the significance for domestic and international economic affairs of the development of multinational corporations. Some commentators believe that the multinational corporation has broken free from its home economy and has become a powerful independent force determining both international economic and political affairs. Others reject this position and believe that the multinational corporation remains a creature of its home economy. This section is devoted to the discussion of MNC role in IPE and most notably in the area of foreign directed investment.

4.1 The Nature And Significance Of MNC

? Dear distance learner, what do you think is a MNC?

Although there are many more technical definitions of a multinational firm, a MNC refers simply to a firm or corporation of a particular nationality with partially or wholly owned subsidiaries within at least one other national economy. Tens of thousands of MNCs with numerous subsidiaries conduct business around the world. Such firms expand overseas primarily through foreign direct investment (FDI), whose purpose is to achieve partial or complete control over marketing, production, or other facilities in another economy; such investments may be in services, manufacturing, or commodities. FDI can entail either the purchase of existing businesses or the building of new facilities (called "greenfield" investment).

Whereas the purpose of portfolio investment is to obtain a financial return on the investment, FDI, as well as alliances, mergers, and similar ventures, are usually part of an international corporate strategy to establish a permanent position in another economy.

In one sense, multinational firms have existed for a very long time. The Dutch East India Company, the Massachusetts Bay Company, and other companies of merchant-adventurers were forerunners of today's MNCs like IBM, Sony, and Daimler-Chrysler. These earlier transnational firms, however, were far more powerful than contemporary MNCs are; they commanded armies and fleets, had their own foreign policies, and controlled vast expanses of territory: the sub- Asian continent (India, Pakistan, and Bangladesh), the East Indies (Indonesia), and South Africa. Modern MNCs are much more modest.

Another major difference between those early transnational firms and today's is that the former were principally interested in agricultural products and extractive industries in particular regions of the world, whereas major firms in the early twenty-first century are principally involved in manufacturing, retailing, and services, tend to operate on a regional or worldwide basis, and usually pursue an international corporate strategy

1.1 The Multinationals And The International Economy

? Dear distance learner, what do you think is the importance of a in the international economy?

The world's largest MNCs account for approximately four-fifths of world industrial output while typically employing two-thirds of their work force at home; they are not nearly as footloose as many critics charge. Foreign direct investment (FDI) has been growing at a rapid rate. Between 1985 and 1990, FDI grew at an average rate of 30 percent a year, an amount four times the growth of world output and three times the growth rate of trade. FDI has in fact become a major determinant of trade patterns. The annual flow of FDI has doubled since 1992 to nearly $350 billion. Intra firm trade—that is, trade among subsidiaries of the same firm—accounted for one-third of American exports and two-fifths of U.S. imported goods in 1994.

About one-half of the trade between Japan and the United States is actually intra firm trade. This intra firm trade takes place at transfer prices set by the firms themselves and within a global corporate strategy that does not necessarily conform to the conventional trade theory based on traditional concepts of comparative advantage. Evidence suggests that these trends will continue and could even accelerate.

The gross statistics, however, hide noteworthy aspects of FDI and of other activities of MNCs. Despite much talk of corporate globalization, FDI is actually highly concentrated and is distributed unevenly around the world. Although FDI has grown rapidly in developing countries, most FDI has been placed in the United States and Europe, while only a small percentage of U.S. foreign direct investment has gone to developing countries. This concentration of FDI is due to the simple fact that the United States and Europe are at present the world's largest markets. Nevertheless, throughout most of the 1990s, FDI in less developed countries (LDCs) grew at about 15 percent annually. However, FDI in LDCs has been highly uneven and concentrated in a small number of countries, including a few in

The increasing importance of MNCs has profoundly altered the structure and functioning of the global economy. These giant firms and their global strategies have become major determinants of trade flows and of the location of industries and other economic activities. Most FDI is in capital and technology-intensive sectors. These firms have become central in the expansion of technology flows to both industrialized and industrializing economies and therefore are important in determining the economic, political, and social welfare of many nations.

Controlling much of the world's investment capital, technology, and access to global markets, such firms have become major players not only in international economic but in international political affairs as well, and this has triggered a backlash in many countries. According to DeAnne Julius, one of the world's most knowledgeable experts on the MNC, the huge expansion of FDI, inter-corporate alliances, and intra-firm trade throughout the 1980s and 1990s reached a level where "a qualitatively different set of linkages" among advanced economies was created; some have estimated that more than twenty thousand corporate alliances were formed in the years 1996–1998. The growing importance of FDI and inter-corporate cooperation means that the world economy has reached a "takeoff" point comparable to that wrought by the great expansion of international trade in the late 1940s and the subsequent emergence of the highly interdependent international trading system. The growth in FDI and in the activities of multinational corporations of many nationalities has linked nations more tightly to one another, and this has further affected the global economy.

The role of MNCs in the world economy remains highly controversial. Critics charge that foreign direct investment and the internationalization of production are transforming the nature of international economic and political affairs in ways that undermine the nation-state and integrate national economies. Impersonal market forces and corporate strategies are believed to dominate the nature and dynamics of the international economic and political system.

While many believe such a development to be highly beneficial for mankind, others regard the MNC as exploiters. These critics believe that giant firms, answerable only to themselves, are integrating societies into an amorphous mass in which individuals and groups lose control over their own lives and are subjugated to firms' exploitative activities. The world, these critics charge, is coming under the sway of a ruthless capitalist imperialism where the only concern is the bottom line.

Many and perhaps most professional economists (with the important exception of business economists), on the other hand, discount the significance of multinational firms in the functioning of the world economy. The neoclassical interpretation acknowledges that large oligopolistic firms may be politically important and may also affect the distribution of income within national economies. However, these economists deny that the investment, marketing, and other economic activities of these firms around the world have any great impact on the "real" economy of international trade, location of economic activities, or national rates of economic or productivity growth. In neoclassical economics, the global location of economic activities and patterns of international trade are determined according to location theory and the principle of comparative advantage.

Both extreme positions are exaggerations. Critics exaggerate the evils of the MNCs and their role in the world economy. Although some MNCs do exploit and damage the world, the MNC as an institution is beneficial to many people worldwide; it is, for example, a major source of capital and technology for economic development. On the other hand, the proponents of the MNCs exaggerate their importance and overstate the internationalization of services and production.

The nation-state remains the predominant actor in international economic affairs, and domestic economies are still the most important feature of the world economy. Although some convergence has been occurring, national societies retain their essential characteristics and are not becoming part of any homogenized amorphous mass. In an era of oligopolistic competition and rapid technological innovation, location theory and the conventional theory of comparative advantage cannot tell the whole story of what is happening in the world economy.

One of the most important recent developments in the world economy has been the internationalization of services and of industrial production, a development facilitated by falling costs for communication and transportation that have enabled firms to integrate production and other activities around the globe. Continuing restructuring of services and manufacturing was extremely important in the nature of the world economy as it entered the new millennium.

Nevertheless, the importance of this development is frequently misunderstood and exaggerated. FDI in the year 2000 is only a small part of the total domestic investment of the rich countries. Furthermore, contrary to the often stated opinion that MNCs have "globalized" technology and put their own firms everywhere on an equal footing for reasons internal to the firms themselves, and because of conditions prevailing in many developing countries, technology tends to diffuse from industrialized to industrializing countries relatively slowly.

Moreover, internationalization of services and production is highly concentrated among the major powers and within particular regions notably Japan in southeast Asia, the euro zone in Eastern Europe, and the US in the NAFTA area. Evidence thus suggests that regionalism as well as globalism characterizes the strategies of multinational firms. While economic competition and financial markets have become increasingly global, production and services are increasingly regional.

The increased importance of regionalization in the world economy raises some disturbing possibilities. The trend toward regionalization could lead to weakening of the post–World War II movement toward trade liberalization. While the MNCs of the major economic powers continue to pursue global strategies and to invest in one another's economies (with the exception caused by Japan's relatively low level of inward FDI), they are also concentrating their own FDI in neighboring countries. Creation of regional rather than global production and sourcing networks has become a notable trend.

UNIT SUMMARY

In this short unit, we have discussed what are often called the enigmatic components of IPE, international trade, finance and monetary relations and also in relation to FDI the role of MNC's. At the heart of the world economy, we have argued, are the issue-areas of international trade and international money and finance. For students of IPE, the critical questions in each of these market domains have to do with government behavior, since for us in political science the fundamental unit of authority remains the individual state. What motivates government policy in these issue-areas, and how are policies preferences best explained and analyzed? Beginning our discussion with issues of international trade and then international money and finance we have attempted to give you a bird eye view of the major components of IPE. In the coming units we will shed light on this very issues under the topic of the governance of IPE and the political economy of north south relations.

Self Test Exercises

Write an essay on each of the following questions

1. Why is the issue of trade of trade so controversial?
2. Outline the basic ways in which mercantilist and liberals view international trade?
3. What was the advantage and the disadvantage of the gold standard compared to the floating exchange rate system of the post-Bretton-wood system?
4. What do you think is the basic difference between the new trade theory and the classical theories?
5. What do you think is the impact of the globalization of finance and the concomitant capital account liberalization on IPE?
6. What are the arguments for and against MNC? Do you think MNC are beneficial to developing countries?

Part II: TRUE/ FALSE

1. The globalization of financial markets has created increased interdependence among nations, since all are linked to the global market.
2. Capital account is an indicator of the impact of international transactions on a nations' wealth.
3. Balance of trade measures the dollar value of payments and receipts for goods and services.
4. Protectionism is the use of tariffs and non-tariffs barriers such as quotas to protect a market that might otherwise be vulnerable to imports.

5. Speculative objects appear and disappear with great frequency in financial markets, seldom creating panics or crises.
6. The anomaly of international trade is that even liberal states declare it "free" while practically adhering to rampant "protectionism".
7. Today, the functions of MNCs are north-north phenomenon than the alleged North-south.
8. In the modern era, determinants of international trade tend to be economic than political.
9. The FDI flow to Africa has been dominant in the industrial sector particularly in areas of extraction.

☑ Unit Checklist

Put an (X) mark in the boxes in front of the ideas you performed well and leave those you doubt blank.
I can

<u>I Can:</u>

- ✓ Identify and explain important terminologies used in the discussion of international trade, m[illegible]y and finance ☐
- ✓ Identify and discuss theories of international trade and the debate over free trade and protectionism ☐
- ✓ Identify and explain evolution of the principles and structure of international monetary relations ☐
- ✓ Define and discuss the nature, structure and evolution of the international financial relations ☐
- ✓ Appreciate the nature, significance and role of foreign directed investment and MNC's in IPE ☐

If you have any doubt about your understanding of any of the above checklists don't hesitate to go back and refer the discussions in the sections

UNIT FOUR

The Governance of International Economy

✪ Unit Introduction

Today, all political economists acknowledge the need for some minimal rules or institutions to govern and regulate economic activities; even the most ardent public-choice economist would agree that laws are needed to enforce contracts and protect property rights. In his pioneering work *Economics of Interdependence* (1968), Richard Cooper went on to evaluate various solutions that had been proposed against the clash between the "irresistible force" of economics and the "immovable object" of politics. He concluded that the ideal solution was some type of international governance of the global economy. Since then, the great need for international governance, the rapid globalization of the world economy has elevated the governance issue to the top of the international politics and economic agenda.

Unit Objectives

Dear learner, by the end of this section you should be able to:

- Identify the scope and the nature of International Regimes and International Economic Governance
- Evaluate the origins of international regimes, contents and objectives of international regimes;
- Distinguish among the existing approaches to the International Economic governance; and
- Appreciate how various international regimes practically govern the economic relations among states of the world.

✷Pre-test Questions

- What, do you think, does the structure and pattern of the international economic governance look like?
- What factors have contributed to the rise of international regimes?

Section One: International Regimes

✪ Section Overview

Dear students! Welcome to the first section of this fourth chapter, which is dedicated to an explanation of the governance of international economy. In this section, you will be introduced with International Regimes and International Economic Governance. Dear students, although you might be familiar with concept of “governance”, here you are concerned about the same issue relation to economic matters at the international level.

An international governance mechanism is needed to assume several functions in the new global economy; in particular, it must provide certain public goods and resolve market failures. Provision of international public goods must include maintaining the rule of law; providing mechanisms for the settlement of disputes in trade and investment and other areas; ensuring monetary and financial stability, setting common standards and regulations for business, managing global communication and transportation, and solving environmental problems.

After the completion of this section, you will be able to;

- define what international economic governance does mean
- scrutinize the origins of international regimes and
- identify the contents and purposes of international regimes
- discuss basic approaches in governing the international economy

1.1 International Regimes and International Economic Governance

? What factors, do you think, have necessitated international economic governance?

Dear students, it is true that neither domestic economies nor the increasingly integrated world economy can rely on markets alone to police themselves. That is why, following the hit of Great Depression and the World War II, the Great Powers [mainly the USA, UK and France] established two sets of economic priorities. The first economic objective was to bring economic growth thereby ensuring full employment, especially in the war torn economies. This is the time when the classical liberal view about the role of the state came to be revisited, in the sense that most of the former liberal governments reflected their commitment to the principle of “interventionism” in the economy. Hence, we have the replacement of the minimal state by the new welfare states built on the concept of “embedded liberalism”.

The second economic priority was the creation of a stable world economic order that would prevent the coming back of the highly protective economic nationalism which featured the international trade in the 1930s. Thus, new international regimes and institutions have emerged to coordinate policy efforts and resolve international disputes that have accompanied these transformations in the global economy, especially international liberal economic order.

? What do we mean by the international liberal economic order?

A liberal international economy is an international economy characterized, at least in ideal terms, by such factors as open markets, freedom of capital movement or mobility, and nondiscrimination alongside the existence of certain agreed rules and regulations to govern it. A liberal economy can succeed only if it provides public goods like a stable monetary system, eliminates market failures, and prevents cheating and free-riding. Although the primary purpose of rules or regimes is to resolve economic problems, many are actually enacted for political rather than for strictly economic reasons. Empirically speaking, a liberal international economy could not politically tolerate too many free-riders who benefit from the opening of other economies but refuse to open their own markets. This position entails some implications for the governance of the global economy. Before delving deep into the discussion of the subject, let us have a brief insight of some of the concepts and approaches involved.

The concept of international regimes, defined as “sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors’ expectations converge in a given area of international relations,” has been at the core of the research on international institutions. Although a distinction can be made between an international regime as rules and understandings and an international institution as a formal organization, the word “regimes” and the word “institutions” are frequently used interchangeably, in writings on international political economy, to refer to bodies that encompass both rules and such formal international organizations, which are important for the functioning of the world economy.

Governing the international economy has always remained to be a challenge, as governments have been able to make domestic public policy and have remained politically independent actors in international affairs. But one possibility has been set forth by Wolfgang H. Reinicke (1998) in his *Global Public Policy: Governing without Government?* He proposed, in the first place, that “government” and the “functions of governance” can be disentangled from one another, at least in the discussions pertaining to IPE. In the modern world, “government” has been referred to formal institutions that enjoy national sovereignty, possess a monopoly of power over a particular territory, and are not answerable to an external authority.

Governance, on the other hand, is a social function that is essential to a market economy at the national or international level, and is not necessarily the same as government. Governance, according to Reinicke, need not be equated with government, but can be achieved through networks of public and private groups or institutions at national, regional, and international levels. While many liberal thinkers believe that only minimal rules are necessary, most scholars of international political economy argue that extensive rules or formal regimes are needed regardless of the level of operation.

1.2 Approaches in Governing the International Economy

? Do you know any approach to international economic governance?

There are three predominant positions regarding: neoliberal institutionalism, new medievalism, and transgovernmentalism.

1.2.1 Neoliberal Institutionalism

Neoliberal institutionalists believe that international institutions have become sufficiently strong to meet the challenges of a globalized international economy. Neoliberal institutionalism, like realism, accepts the continued existence and importance of the nation-state in international affairs. However, it generally assumes that the state is a liberal, market-oriented state, more interested in cooperation and absolute gains than in conflicts over relative gains. Although neoliberal institutionalism is based on the assumption of the importance of the state, and the belief that formal international regimes and institutions are necessary, it does not emphasizes the ever-present problem of interstate conflict and rivalry. Neoliberal institutionalism stresses interstate cooperation, unlike state-realism.

The types of international regimes and institutions advocated by neoliberal institutionalism have achieved considerable success. Despite some failings, the IMF, WB, and GATT/WTO have improved significantly the ways in which the international economy functions.

? Dear student! What limitations, do you think, does this approach have?

This approach of international governance has a number of limitations. There are formidable obstacles to achievement of the neoliberal institutionalist ideal of a regime-based international economy. As the world has become more integrated and complex new issues have arisen, a number of existing regimes have proven to be quite inadequate to fulfill the tasks assigned to them. For example, the regimes governing the areas of finance and money have proved seriously deficient. The increased integration and instability of financial markets and exchange rate fluctuations pose a serious threat to the stability of the global economy. Efforts to create an international regime for multinational corporations, such as the multilateral investment agreement, have reached stalemate because of strong opposition from many countries and powerful interest groups. There is no regime for "economic development", one of the most pressing issues in the world.

Indeed, there are few generally accepted principles and policy prescriptions upon which regimes can be constructed. These are based on such Western legal and economic ideas as the transparency of commercial dealings and limited state intervention in the economy, and the triumph of neoliberalism in the 1980s reinforced such liberal principles. However, as economic integration spread among many and more diverse economies and also deepened, fundamental differences among national systems of political economy regarding economic principles and legitimate policy have challenged Western ideals. For instance, Americans' and Japanese' notions of what is fair in international economic competition are particularly divergent. The clash between different national systems of political economy has intensified, while many expect that the process of convergence will eventually lead to worldwide acceptance of the policy prescriptions of neoclassical economics and a free market. An increase in the regionalization of the global economy has proved to be a popular way of dealing with the problems created by such national differences.

1.2.2 The New Medievalism (Neo-medievalism)

The medieval world of Western Europe, from approximately the fifth to the fifteenth centuries, shared a heritage of Christianity and Roman law. The ruling aristocracy of each major European country shared many similar ideas, norms, and values as well as some similar socio-political structures (E.g. feudalism, the Church, and kingship); despite its continual political, religious, and social strife. This era, the rise of the modern territorial state was also characterized by fragile and dispersed concentrations of economic and political power with a limited technology and level of organizational skills for mobilization and effective use of economic and military capabilities. And, the neomedievalist is a reconsideration of the medieval model of governance.

The new medievalism is based on the assumption that the state and the state-system have been undermined by economic, technological, and other developments and are being eclipsed by nongovernmental actors and the emergence of an international civil society. New medievalists believe that the end of national sovereignty and the resulting diffusion of power will enable selfless nongovernmental organizations (NGOs) to solve the world's pressing environmental and other problems.

A major theme of the new medievalism is that nongovernmental organizations (NGOs) have, or at least should have, a central role in the governance of international or "*post-national*," affairs. The "new medievalism," based on the belief that the world is experiencing the end of national sovereignty, implicitly rejects the idea of a liberal international economic order based on cooperation among sovereign states. Organized primarily around such specific issues as safeguarding the environment, protecting human rights, and promoting a safer world, NGOs are believed to have become a significant force in particular issue areas.

Some add that the increasing importance of NGOs in international affairs is a positive factor in the emergence of a "global civil society." The emerging international civil society is said to be composed of domestic and transnational nongovernmental groups, organized primarily around strong policy concerns like the environment and elimination of nuclear weapons. The nongovernmental organizations (NGOs) and global social movements that constitute global civil society are strongly motivated by opposition to the alleged evils of national governments, multinational firms, and globalization; although it is well known that they are product of globalization, themselves.

Although proponents of the new medievalism speak of the emergence of a global civic culture of shared values and understandings that could provide social and political foundations for an NGO-managed world, evidence supporting such a contention is hardly convincing. In so far as a post-national, global civic culture does exist, it is mainly limited to Western civilization. Yet, even in the West, powerful nationalistic, ethnic, and racial conflicts persist.

Knowledge of the history of the twentieth century makes it difficult to accept the argument of many human rights advocates that abusers of human rights will be deterred from further abusive activities because they have become subject to international exposure. This episode indicates that the problem of governing without government exists, because international governance will not work without power and, unfortunately, governance mechanism lacks the power needed to achieve compliance with its decisions.

1.2.3 Transgovernmentalism

Transgovernmentalism argues that international cooperation by domestic government agencies in specific functional areas is rapidly replacing the decision-making functions of centralized national governments in the management of the global economy. Transgovernmentalism poses a third possibility for a rule-based international economic and political order. Like liberal internationalism, and unlike the new medievalism, this position accepts the continued existence of nation-states. However, the nature of the state envisioned by this intellectual position is fundamentally different from that in state-centric liberal internationalism and political realism. Like the new medievalism, this position assumes that the governance functions of the state can be divided and delegated to intergovernmental bodies or networks dealing with specific policy issues.

The scholars of this school point out that many transgovernmental organizations already exist to deal with such matters as banking regulations, antitrust regulation, and judicial matters. These transnational networks composed of technical experts, business executives, and lawyers are needed to manage an increasingly complex and integrated world in which extensive technical input is required. Yet, it would be a large leap from transgovernmental mechanisms in specific policy areas to international governance of the globe. This position assumes that technical and other functional problems can be solved in isolation from larger national concerns and parochial political matters. Technical issues are believed to be separate from politics and, thus, can be solved independently. Regulatory matters, for example, can be isolated from national economic priorities and from the pressures of powerful interests. Finally, transgovernmentalism ignores matters of national security and foreign policy and assumes no hierarchy or priority among the issues of interest to governments.

Transgovernmentalism foresees a world stripped of power, national interests, and interstate conflict, a world in which technocrats, bureaucrats, and the like solve issues outside the realm of politics. While stressing the absolute gains from transgovernmental cooperation, transgovernmentalism is silent on the matters of relative gains and distributive questions that arise in almost every serious international discussion of substantive issues. Thus, transgovernmentalism envisions a world nearly devoid of both domestic and international politics. Transgovernmental networks can be very useful in the solution of the many issues that have arisen and will continue to arise. However, this approach to governance of the global economy is severely limited by the political rivalries and conflicting interests among nation-states and powerful domestic constituencies.

Activity – 1

1. What do you understand by the international regimes and international economic governance?____

Section Two: Major International Economic Organizations

✪ Section Overview

Dear students! In the previous section you have learnt about the essence and meaning of international governance, as well as some of the approaches relating to it. Now, you get acquaintance with some of the international regimes that governed the international economy with more emphasis to the post World War II. The world economy would have difficulty functioning without these institutions. Therefore, understanding their functioning has become an extremely important concern of political economists.

The most important institutions came out of the Monetary and Financial Conference held in 1944 at Bretton Woods [New Hampshire, USA] laying the basis for envisioned stability of world economic order *via* establishing International Financial Institutions [IFIs], namely the International Monetary Fund [IMF] and the International Bank for Reconstruction and Development [IBRD] commonly known as the World Bank [WB]. Taken together, the IMF and the World Bank are often known as the Bretton Woods Institutions named after the place of Conference that gave birth to the two IFIs. The other important international regime is the World Trade Organization [TWO]. We will have a look at each of these international institutions that functioned the post war era.

Section objectives

Dear learner after the completion of this section, you will be able to;

- List the major international regimes in economic governance
- Analyze the objectives, operational mechanisms and performance of the international financial institutions (World Bank & IMF) and GATT/WTO
- Make a comparison in a way to understand the basic similarities and differences

2.1 Bretton Wood Institutions: IMF and IBRD (WB)

? Have you ever heard of people referring to the IMF and WB as Bretton wood institutions and what do you think is the reason?

The Bretton Woods Institutions are IFIs that laid down regulatory (organizational) framework within which the international economy has to operate, more specifically by shaping the manner in which international payments are conducted. This system envisions a world in which governments have a meaningful freedom to pursue domestic (national) economic objectives. But at the same time, a monetary order was to be brought through establishment of fixed exchange rates. And, this was believed to prevent the destructive competitive depreciations that most nations have been making use of, in 1930s. At any rate, the basic principles in which the Bretton Woods System operates are found to be three. These are: autonomy of national economic policies, fixed exchange rates and currency convertibility. The principles are meant to resolve the inherent conflict between national autonomy and international stability.

2.1.1 International Monetary Fund [IMF]

2.1.1.1 IMF's Formation, Objectives and Functional Mechanisms

International Monetary Fund (IMF) is international economic organization established by the Bretton Woods Conference, in 1944. However, it began its operations in 1947 with headquarter in Washington, D.C. The IMF operates as a United Nation's specialized agency. The IMF membership is open to all independent nations and currently it has more than 180 countries.

As far as the organizational leadership is concerned, the board of governors, made up of leading monetary officials from each of the member nations, is the highest authority in the IMF. Day-to-day operations are the responsibility of the 24-member executive board, which represents member nations individually (for larger countries) or in groups. The managing director serves as chairperson of the executive board.

? What are the objectives of IMF?

Dear learners, IMF attempts to promote international monetary cooperation, and to facilitate the expansion of international trade. The basic objectives of IMF are "removal of trade barriers (restrictions)" and "maintenance of stable exchange rates among national economies." Hence, IMF was in essence created to supervise the operation of monetary system; mid-term lending to countries experiencing temporary balance-of-payment difficulties and permitting a nation to change its exchange rate with the consent of the international consent in case it has a "fundamental disequilibrium". It serves as a permanent forum for consideration of issues of international payments, in which member nations are encouraged to maintain an orderly pattern of exchange rates and to avoid restrictive exchange practices.

It has already been mentioned above that, originally, international monetary system was designed conforming to the fundamental principle of fixed exchange rates in order to overcome economic anarchy of the earlier decade. This time, it was intended to provide monetary reserves sufficient to enable member governments to maintain the exchange rates for their currencies at predetermined values in such a way to use contributions from member countries and to offer reserve credits to states with international payments problems. It was also meant to prevent global inflation or competitive devaluation.

? What are the mechanisms to build and maintain an effective international monetary system?

Stabilization of a monetary system can be achieved by tying every currency to a "nonmonetary" asset (gold being the asset of choice), by coordinating national monetary policies, or by following a leader whose past policies promise that it will provide the desired degree of economic stability in the future. Although all three methods were in fact employed in the early postwar years, the monetary policies of member states were fastened by tying every currency to the dollar, which in turn was tied to gold. Even the major powers coordinated their economic policies only informally.

In view of the attainment of autonomy and stability, some degree of flexibility was also maintained to enable individual states to deal with extraordinary situations (including pursuit of full employment), reliable reserve credit in the event of an international payments problem, and agreement among member countries to peg their currencies to the dollar at $35 an ounce in gold.

The postwar monetary system of fixed rates, which lasted until the early 1970s, proved extraordinarily successful. However, as we have discussed in chapter three, by the time of the Vietnam War in the 1960s, the United States had ceased to pursue price stability. Rising inflation caused by that war eventually led the Nixon Administration to abandon the fixed-rate system in August 1971. Yet, the United States and the dollar remained central to the system.

The "hegemony" of the dollar conferred "extravagant privileges" on the United States, because it alone could simply print dollars to fight foreign wars, could buy up foreign businesses, and could go deeply into debt without fearing negative consequences. However, the gradual decreased of confidence in the dollar led to intensifying speculation in gold, and this was followed by futile attempts to find ways to recreate confidence in the system.

Hence, in the late 1960s Special Drawing Rights (SDRs) were created as the Fund's unit of account and as a new reserve asset, although they were never utilized extensively. Because of lack of political solution, the dominant position of the dollar was maintained. However, as soaring inflation undercut the value of the dollar, a more fundamental economic solution was needed. Subsequent efforts of an international committee to develop a new system of stable exchange rates failed. The overwhelming problems posed by increased capital mobility, along with fundamental differences between the United States and Western Europe over any new system, made agreement impossible.

Moreover, the huge OPEC monetary surplus following the first oil crisis, and the need to recycle those funds, proved important in the development of the international financial market. Before the end of the 1970s, the scale and velocity of international financial flows had expanded enormously and had truly transformed the international economic system. This situation was described by some as a "non-system", because there were no generally recognized rules to guide the flexible rates or any other decisions on international monetary affairs.

As a consequence of this impasse, the major industrial powers accepted economic reality at the Jamaica Conference (1976) and instituted flexible rates. The international monetary system was thus changed, at least *de facto*, from one based on fixed exchange rates to one based on flexible rates. Integration of global financial markets and increased monetary and financial interdependence of national economies had a significant impact on domestic as well as international economics. Financial market integration means that the macroeconomic policies of one country have a significant impact on the economic welfare of other countries.

? How does the flexible exchange rate increase the financial interdependence of national economies?

For example, if country *A* raises its interest rates to decrease domestic inflationary pressures, those higher rates will attract capital from other countries with lower interest rates, and the resulting increase in country *A*'s money supply then contributes to the inflationary pressures that higher interest rates were intended to counter. Simultaneously, economic activity is reduced in the economies from which the capital flows.

Therefore, the integration of national financial markets actually reduced macroeconomic policy autonomy. Despite the shift to flexible exchange rates, domestic and international economic spheres became even more closely linked to one another because of financial market integration. Increased interdependence also has integrated such once-isolated policy issues as trade flows and exchange rate determination, thus immensely complicating the task of managing the world economy and raising important questions about the adequacy of the rules governing international economic affairs.

2.1.1.2 Controversial Issues of IMF's Reform: Technical and Political Issues

Economists' theories, about the varied and complex aspects of the international monetary regime, have usually followed rather than preceded events that they attempt to explain. Indeed, many theories regarding monetary affairs have been merely *ex-post-facto* explanations of important developments that economists had failed to predict.

Although an efficient international monetary system benefits every country, serious political and economic difficulties almost invariably impede creation or reform of an international monetary system. The creation (or reform) of an international monetary system involves highly complex technical issues. The formal models and mathematical techniques of economists that are required to deal with monetary and financial matters are beyond the technical competence of most non-economists, and even beyond many economists.

Yet the international monetary system is of intense concern and importance to national governments and private economic interests. The mechanisms responsible for the system's efficient functioning—adjustment, liquidity creation, and confidence-building measures—produce a differential impact on the national interests of various countries and also on the interests of powerful groups within economies.

The distributive consequences of solutions to technical problems are illustrated by the liquidity issue, which is closely tied to the issue of 'seigniorage', i.e. that is, the economic benefits accruing to the country whose currency is used as the basis of the international monetary system. Solutions to the adjustment problem determine whether deficit or surplus countries must pay the high costs of reestablishing a balance-of-payments equilibrium.

Technical mechanisms are seldom politically neutral; they affect the economic welfare, political autonomy, and even the international prestige of individual states, and they also have an impact on the interests of capital, labor, and other domestic groups.

Political differences mean that a well-functioning monetary system requires strong leadership by a nation or group of nations with an interest in maintaining the system. The leader(s) must assume the initiative in solving highly technical problems as well as providing and managing the key currency used for maintaining reserves, carrying out economic transactions, and providing liquidity. Furthermore, the leader should be the "lender of last resort" and from time to time should provide financial assistance to countries experiencing severe financial problems. Although this leadership role could, in theory, be provided by two or more nations or even by an international organization, leadership has historically been provided by a dominant economic and military power; for example, Great Britain in the late nineteenth century and the United States following World War II. Not surprisingly, the rules governing the international monetary system have in general reflected the interests of the leading economic powers.

The other main issue of debate has been the functionality of the IMF's policy of adjustment. An international monetary regime must determine the method by which national economies will restore equilibrium (i.e., reduce a deficit or a surplus) in their international accounts (balance of payments), and an efficient international monetary system should minimize the costs of making adjustments. Every adjustment policy results in economic costs, and some methods of adjustment are considerably more costly for individual economies and for the overall world economy than are others.

Both deficit and surplus countries employ additional methods to overcome payments imbalances. One such method is to change the exchange rate by devaluing the currency (a deficit country) or appreciating it (a surplus country). Another method is to make changes in macroeconomic policy; that is, to shift to deflationary (a deficit country) or expansionary (a surplus country) economic policies. The rules governing the international monetary system will determine the approved methods of making such an adjustment.

However, it is clear that all countries, regardless of the choices available would like to shift as many adjustment costs as possible to others and away from themselves. Working out the distribution of the costs of adjustment among deficit and surplus nations is at the heart of solving the adjustment problem.

The problem of devising a stable and politically acceptable international monetary system is further compounded by the inevitable trade-offs among the following equally desirable goals: fixed exchange rates, national independence in monetary policy, and capital mobility. These three goals are referred to by economists as a "trilemma", or as the "irreconcilable trinity". Nations may want stable exchange rates to reduce economic uncertainty, but they may also desire discretionary monetary policy in order to promote economic growth and steer their economies between recession and inflation. In addition, governments may want freedom of capital movements to facilitate the conduct of trade, foreign investment, and other international business activities. Unfortunately, no international monetary and financial system can accommodate all three of these desirable goals (fixed exchange rates, national independence in monetary policy, and capital mobility), although it can incorporate at most two of these objectives.

2.2 The World Bank: Organization, Objectives and Functions

? Do you know the WB's main functions, and the Bank's sources of funds?

International Bank for Reconstruction and Development, rather commonly known as the World Bank, is another specialized United Nations agency established at the Bretton Woods Conference in 1944 alongside with the IMF. The World Bank was designed to meet the three main objectives: (i) assisting in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes; (i) promoting private foreign investment by means of guarantees or participation in loans; and (iii) supplementing private investment by providing, on suitable conditions, finance for productive purposes out of its own capital.

Conventionally, the Bank's leadership has mainly been of the USA, unlike the IMF that has always been led by the West Europe. As an organization, all powers of the bank are vested in a board of governors, comprising one governor appointed by each member nation. The board meets at least once annually. The governors delegate most of their powers to 24 executive directors, who meet regularly at the central headquarters of the bank in Washington, D.C. Five of the executive directors are appointed by the five member states that hold the largest number of capital shares in the bank. The remaining 19 directors are elected by the governors from the other member nations and serve two-year terms. The executive directors are headed by the president of the World Bank, whom they elect for a five-year term, and who must be neither a governor nor a director.

The bank's functions are of three types: lending, non-lending and grants. The Bank provides investment loans that fund actual projects like road building; adjustment loans, the WB's most controversial activity, through which it funds nations that wish to make changes in their policies; and financial intermediary loans or funds funneled through a country's financial system for some commonly agreed objectives.

The bank's working funds are derived from sales of its interest-bearing bonds and notes in capital markets of the world, from repayment of earlier loans, and from profits on its own operations since its creation. Members of the World Bank must buy shares of the capital stock of the bank. The minimum number of shares that a member nation must purchase varies according to the relative strength of its national economy. Currently, the United States is the largest shareholder, followed by Japan, Germany, the United Kingdom, and France.

Traditionally, the Bank grants loans only to member nations, for the purpose of financing specific projects. Before a nation can secure a loan, advisers and experts representing the Bank must determine that the prospective borrower can meet conditions stipulated by the bank. Most of these conditions are designed to ensure that: loans will be used productively and that they will be repaid; the bank requires that the borrower be unable to secure a loan for the particular project from any other source on reasonable terms, and the prospective project be technically feasible and economically sound.

To ensure repayment, member governments must guarantee loans made to private matters within their territories. After the loan has been made, the bank requires periodic reports both from the borrower and from its own observers on the use of the loan and on the progress of the project. Its first loans were made to the European countries and to Japan to help reconstruct countries devastated by the war. Most people, including most Japanese, are not aware that the WB financed Japan's famous bullet train. In Europe, Finland received the first loan. For quite a long time, the WB's clients were countries that today are considered wealthy. Gradually, however, most loans have been granted to economically developing countries in Africa, Asia, and Latin America.

In the 1950s, the WB's emphasis was growth and development. In the 1960s, it was rural development; and in the 1970s, economic reform. In the 1980s, there was a major shift in the WB's policies toward human development and assistance to developing countries. In the 1990s and 2000s, the WB has basically focused on poverty reduction. Beginning of the 21st century, it is the issue and need of the developing countries, especially the poorest ones, came to the scene of the global agenda.

The bank has given particular attention to projects that could directly benefit the poorest people in developing nations by helping them to raise their productivity and to gain access to such necessities as safe water and waste-disposal facilities, health care, family-planning assistance, nutrition, education, and housing. Direct involvement of the poorest people in economic activity has been promoted by providing loans for agriculture and rural development, small-scale enterprises, and urban development. The bank has also expanded its assistance to energy development and ecological concerns.

Yet, the Bank is severely criticized the role the WB would play was not clear. One area it was sure about was that, as a financial source, it could fund and guide environmentally friendly programs. The WB began looking for projects that would improve the environment and make it a resource to improve people's lives.

2.3 Postwar Trade Regime: The GATT and WTO

? Dear student who do you think is responsible for the governance of international trade?

Despite the different regions' experience of the dramatically uneven patterns of economic growth throughout the world, the pace and size of international economic transactions has risen steadily, as the world has experienced in the second half of the 20^{th} century. New institutions have developed to promote and manage the world's trade. From 1948 to 1995, nations negotiated a series of treaties through the General Agreement on Tariffs and Trade (GATT), which gradually lowered tariffs for most manufactured goods. In the 1990s the GATT transformed itself into the World Trade Organization (WTO), with more powers of enforcement and a broader mandate to promote trade.

2.3.1 The General Agreement on Tariffs and Trade (GATT)

? Dear students what do you think is the difference between GATT and WTO?

As we have seen above, the Bretton Woods institutions are the result of attempt of the allied power, led by USA and UK; to restructure the world political economy in the post war era in such a way to prevent potential economic conflicts like those led to the outbreak of the WWII. But, it is not commonly known that the conference also advocated the formation of *'International Trade Organization'* [ITO]. In his original concept, John M. Keynes thought that this organization would be responsible for stabilization of the prices of primary products by employing different mechanisms. At the time, ITO was proposed to oversee the new liberal trade rules as it applies to tariffs, subsidies, and other protectionist measures that states may utilize.

The whole idea was that ITO would serve as an international counterbalance against domestic tendencies of protectionism. However, ITO did not take the ground for the U.S. congress soon forced the government to withdraw the negotiation. The H. Truman's government soon proposed a temporary alternative structure of multilateral trade negotiations, called rounds, under the *General Agreement on Tariff and Trade* [GATT]. GATT was signed by 23 nations at a trade conference in 1947 and became effective in January 1948.

Upon its establishment, GATT was not more than what its title suggested: *a forum for bringing the countries together and to reach agreement on trade and tariff issues*. GATT also originated as a "charter" for the proposed International Trade Organization (ITO), which was to be a specialized agency of the United Nations. Although the ITO failed to win ratification by the United States Congress in 1950 and never came into being, the GATT remained in use to govern international trade. Hence, GATT was both *treaty* and *organization* of international trade in existence from 1948 to 1995.

GATT members, known as 'contracting parties', worked to minimize tariffs, quotas, preferential trade agreements between countries, and other barriers to international trade.

? What are the main objectives of GATT?

Dear learners, the major objective of GATT was to augment trade by removing its barriers in various forms. More specifically, this aim targeted at what is known as "tariffication", i.e. converting non-tariff barriers [NTBs] to be followed by lowering the existing tariff levels. The other objective of GATT was the "universalization" of trade relations. This was to be materialized in a way of extending the scope of most favoured nations [MFN] concept. The simple definition of this concept is that, the trade concessions agreed upon between any two countries would automatically be extended to other member countries of GATT.

GATT was founded on three principles. These principles are (i) "non-discrimination", "multilateralism" and the application of "most-favoured-nation" [MFN], (ii) the expansion of trade by reducing barriers, and (iii) unconditional reciprocity to all member nations bound by the treaty, which required members to treat one another in the same manner if not equally. Once a member reduced a tariff for another member country, that reduction applied to all member countries. However, an escape clause allowed a nation to withdraw its tariff reduction if it seriously harmed the country's domestic producers.

Accordingly, both the industrialized and industrializing economies have taken a number of initiatives, under American leadership, to lower trade and investment barriers. GATT members sponsored eight specially organized rounds of trade negotiations: *Geneva* round 1947, *Annecy* (France) round 1949, *Torquay* (UK) round 1951, *Geneva* (for the second time) round 1956, *Dillon* round 1960-61, *Kennedy* round 1964-67, *Tokyo* round 1973-79, and *Uruguay* round 1986-93.

By the mid-1980s, the GATT trade regime was no longer adequate to deal with a highly integrated world economy characterized by oligopolistic competition, scale economies, and dynamic comparative advantage. In addition, the "new protectionism" of the 1970s had led to the erection of numerous nontariff barriers, such as quotas and government subsidies. The "new protectionism", as distinct from the "old" protectionism, was particularly characterized by hidden trade barriers, a shift from rules to discretion, and a return to bilateralism. Moreover, the character of trade itself has changed and outgrown the rules and trading regime of the early postwar era. Trade became closely intertwined with the global activities of multinational firms, and trade in both services and manufactures expanded rapidly. Trade among industrialized countries became the most prominent feature of the trading system.

Nevertheless, all the eight rounds of multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT), the principal forum for trade liberalization, have significantly decreased trade barriers. However, another development in the 1980s was the so-called "new regionalism". Especially the acceleration of the movement toward European integration was recognized as a threat to the multilateral trading system. From the mentioned time onwards, the U.S.A. pressured its West European and other trading partners for a new round of trade negotiations to strengthen the multilateral trading system. Eventually, this American pressure overcame European and other resistance, and the Uruguay Round of trade negotiations was launched at Punta del Este, Uruguay, in 1986, resulting in intense negotiations until it ended in 1994.

The Uruguay Round was crucial as it came out of the dynamic nature of world economic development and the accompanying debates that lasted for over four decades.

? Why is the Uruguay round regarded as the most important in the development of the post-war trade regime?

The treaty produced by the Uruguay Round, which came into force on January 1, 1995, reduced tariffs on manufactured goods and lowered trade barriers in a number of important areas. At the same time, the formal tariffs on merchandise goods were reduced to the lowest level. The Uruguay Round decreased or eliminated many import quotas and subsidies. The agreement's twenty-nine separate accords also reduced trade barriers and for the first time extended trade rules to a number of areas that included agriculture, textiles, services, intellectual property rights, and foreign investment.

In doing this, the Round took an important step toward completion of the framework of international institutions that had originally been proposed at Bretton Woods (1944). At the end of the negotiations, the members of GATT, as well as representatives from seven other nations, signed a trade pact that will eventually cut tariffs overall by about one-third and reduce or eliminate other obstacles to trade. The pact also took steps toward opening trade in investments and services among member nations and strengthening protection for intellectual property—that is, creative works that can be protected legally.

While the first round [Geneva 1947-48] with its 23 participants took only few months, the last round i.e. Uruguay round, with 108 members lasted for more than six years. The Dunkel draft, on which the Marrakesh agreement was made in April 1994, was a bulky document that contained in itself 28 proposed accords. Thus, the Marrakesh Treaty happened to be one of the most ambitious international trade agreements to be signed by such a large number of nations.

Many of the supporters of the agreement said it would create jobs and improve business. On the other hand, opponents claimed that the new GATT treaty would lead to massive losses of jobs in manufacturing and that the powerful WTO would threaten independence nations. A number of groups, including environmentalists, human-rights activists, and labour organizations in liberal democratic states and other countries, argued against the treaty, claiming that it failed to link trade preferences to protections for the environment and workers' rights.

The ultimate goal of GATT, i.e. "establishing a world trade regime or universal rules for the conduct of commercial policy" seemed real, when the 1994 trade agreement officially took effect and fully implemented in January 1995. As such, this pact, while providing for the establishment of the World Trade Organization (WTO), facilitated the takeover of GATT's functions by the WTO, an international body that administers trade laws and provides a forum for settling trade disputes among nations.

In addition, more and more nations have been pursuing neoliberal economic policies. These developments have resulted in an increasingly market-oriented global economy. Despite the impressive achievements, however, of the Uruguay Round in reducing trade barriers, many vexing issues were left unresolved.

2.3.2 World Trade Organization (WTO)

The World Trade Organization was created to replace GATT, when the members of the latter signed a new trade pact established in 1994, and began operation on 1st January of 1995. After the transition period, GATT ceased to exist. All of the 128 nations that were contracting parties to the new GATT pact at the end of 1994 became members of the WTO upon ratifying the GATT pact. A number of other nations have joined the WTO since then.

World Trade Organization [WTO], based in Geneva, is an international body that promotes and enforces the provisions of trade laws and regulations. It has the authority to administer and police new and existing free trade agreements, to oversee world trade practices, and to settle trade disputes among member states.

As far as the organizational leadership is concerned, the WTO is controlled by a General Council made up of member states' ambassadors who also serve on various subsidiary and specialist committees. The ministerial conference, which meets every two years and appoints the WTO's director-general, oversees the General Council.

? What significant changes were made and continuities maintained?

The World Trade Organization (WTO) is, in essence, an American creation. The WTO's predecessor, the General Agreement on Tariffs and Trade (GATT) had served well America's fading mass production economy, but it did not serve the emerging economy equally well. In effect, WTO has the primary responsibility to facilitate international economic cooperation in trade liberalization. The agreement that established the WTO expanded and entrenched the GATT principle that trade should be governed by multilateral rules rather than by unilateral actions or bilateral negotiations.

Although the WTO incorporated the GATT along with many of its rules and practices, the legal mandate and institutional structure of the WTO were designed to enable it to play a much more important role than the GATT had played in governance of international commerce. The WTO has more extensive and more binding rules. It has also created a trade-policy-review mechanism to monitor member countries.

It is true that WTO was not given as extensive rule-making authority, as some desired. However, it does have much more authority than the GATT. The GATT dispute-settlement mechanism was incorporated in the WTO, reformed, and greatly strengthened by elimination of such basic flaws as long delays in the proceedings of dispute panels, the ability of disputants to block proceedings, and the frequent failure of members to implement decisions. The agreement also established a new appellate body to oversee the work of the dispute panels.

Most importantly, and perhaps controversially, the WTO was empowered to levy fines on countries that refused to accept a decision of the dispute panel. Although the WTO operates a dispute settlement process similar to the one under GATT, it has stronger power to enforce agreements, including authority to issue trade sanctions against a country that refuses to revoke an offending law or practice. WTO has also a significantly broader scope than that of GATT. GATT regulated trade in merchandise goods. The WTO expanded the GATT agreement to include trade in services, such as international telephone service, and protections for intellectual property, i.e. creative works that can be protected legally, such as sound recordings and computer programs.

The institutional structure of the trade regime also changed significantly. Whereas the GATT had been a trade accord supported by a secretariat, the WTO is a membership organization that increases the legal coherence among its wide-ranging rights and obligations and establishes a permanent forum for negotiations. Periodic ministerial meetings increase political guidance to the institution. The WTO is also a formally structured organization whose rules are legally binding on its member states. The organization provides a framework for international trade law. Members can refer trade disputes to the WTO where a dispute panel composed of WTO officials serves as arbitrator. Members can appeal this panel's rulings to a WTO appellate body whose decisions are final. Disputes must be resolved within the time limits set by WTO rules.

? What are some of the criticisms against WTO?

Since its creation, the WTO has attracted criticism from those concerned about free trade and economic globalization. While the advocates of the WTO argue that it plays a critical role in helping expand world trade and raise living standards around the world, the opponents of the WTO have forwarded several arguments some of which are outlined below.

WTO as an organization is "too powerful" and it can declare the laws and regulations of sovereign nations in violation of trade rules, in effect pressuring nations to change these laws. Critiques of WTO also argue that trade rules do not sufficiently protect workers' rights, the environment, human rights or human health. It is also accused of the widespread *democratic deficit.* Claims argue that the Organization lacks democratic accountability, because its hearings on trade disputes are closed to the public and press. However, the WTO officials have tended to reject this argument, claiming that its member nations, most of which are democracies, wrote the WTO rules and selected its leadership.

Trade in certain areas such as agriculture, textiles, and shipping continues to be highly protected. The failure to reduce tariffs on agriculture and textiles was and continues to be especially vexing because lower tariffs would greatly benefit LDCs. Trade barriers are still high in most developing countries, especially with respect to services, and developed countries continue to restrict imports of automobiles, steel, textiles, consumer electronics, and agricultural products. Even more menacing, in most cases, public opinion has become more skeptical of the costs and benefits of trade, and by the late 1990s the WTO and trade liberalization were clearly on the defensive. Scholars criticize the WTO's propagation of free trade within an overall neoliberal conception of economic growth, justified through the universalistic belief that everyone benefits (mainly as consumers) from trade and growth. This has not in fact produced economic growth and higher incomes for poor countries and people.

Doubts are also arising due to the fact that with over 130 members, the WTO's ability to carry out its assigned responsibilities is subject to doubt. Criticism of the WTO reached an apex in late 1999, when more than 30,000 protesters disrupted a WTO summit in Seattle, Washington. The protesters called for reforms that would make the organization more responsive to consumers, workers, and environmentalists. The summit failed in its goal to set an agenda for a new round of global trade talks, largely because of disagreements between industrialized and developing nations in areas like the agricultural subsidies provided by the former nations, notably the support of EU and U.S.A. to their farmers. Developing countries objected to the extent of the subsidies, which amount to about $300 billion annually, arguing that such generous support artificially lowered world crop prices and made it difficult, if not impossible, for farmers in developing countries to compete. The failure of the richer nations to reach agreement on lowering agricultural subsidies continued to derail trade talks in the early 2000s.

In addition, the volume of world trade expanded and trade penetrated more and more deeply into national societies. And, it became increasingly entwined with politically sensitive matters and came into conflict with powerful domestic interests, especially in the United States. This development has produced the "new trade agenda," which includes such highly controversial issues as labor standards, human rights, the environment, and national sovereignty. Although some proponents of the new trade agenda are unalterably opposed to free trade and are even outright protectionists, most advocates of one or another of the issues on the new trade agenda want radical changes in the WTO that would, most experts believe, greatly weaken the trade regime.

Examination of the new trade agenda and the intense political controversy surrounding various items reveals serious threats to the trade regime that will be difficult to overcome. On the other hand, most economists, governments, and business groups are strongly opposed to integrating several issues into international trade negotiations, fearing that, however well some groups intended are, the important issues of labor standards, human rights, and environmental protection will be and are being exploited by outright protectionists.

UNIT SUMMARY

At the turn of the twenty first century, resolution of the governance issue of the international economic order is confronted by many fundamental issues. As more and more nations are formed, national identities are becoming more numerous and, in some cases, more intense. Modern states are highly self-centered and are seldom concerned with the welfare of other peoples. Under such circumstances, talk of substituting global governance for the primacy of nation-states is in vain. The best for which one can hope is that the major powers, in their own self-interest as well as that of the world in general, will cooperate to fashion a more stable and humane international political and economic order.

Reforms that will make that will make the existing institutions more accountable and sensitive to noneconomic matters are required. In the increasingly integrated global economy of the twenty-first century, the battleground has become the entire globe, and the types as well as the number of participants have greatly expanded to include states, international organizations, and nongovernmental organizations.

Self test exercises

Choose the *Best* Answer from among the Given Alternatives

1. One of the following is **NOT** among the objectives of the World Bank, at least "*in principle*":
   A. Assisting in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes
   B. Supplementing private investment by providing, on suitable conditions, finance for productive purposes out of its own capital
   C. Removal of trade tariff and non-tariff barriers
   D. All E. None
2. WB and IMF '*conditionalities*' on the disbursement of aid and loans are parts of the attempt to redress the argument against aid that holds:
   A. Aid has failed.
   B. Aid has created and sustained a situation of dependency syndrome.
   C. Aid seems to be meaningless compared to the benefits of free trade.

D. Aid has been misused.

E. B & C

3. General Agreement on Tariffs and Trade [GATT] was **NOT**:

A. a forum for bringing the countries together and to reach agreement on trade and tariff issues.

B. both treaty and organization of international trade.

C. Built on the former Most Favoured Nation principle as it applied for bilateral trade relations.aimed at universalizaion of trade relations.

D. All

4. Unlike its predecessor, WTO:

A. has come up with a unique dispute settlement process.

B. has a significantly broader scope as it came to include regulation of trade in merchandise goods.

C. has incapable machinery and power to enforce agreements

D. is a loosely structured organization whose rules are optional to be considered as legally binding on its member states.

E. All

F. None

☑ Unit Checklist

Put an (X) mark in the boxes in front of the ideas you performed well and leave those you doubt blank. I can

I Can:

- Identify the scope and the nature of International Regimes and International Economic Governance
- Evaluate the origins of international regimes, contents and objectives of international regimes;
- Distinguish among the existing approaches to the International Economic governance; and
- Appreciate how various international regimes practically govern the economic relations among states of the world.

If you have any doubt about your understanding of any of the above checklists don't hesitate to go back and refer the discussions in the sections

UNIT FIVE

The Political Economy of Regional Integration

✪ Unit Introduction

The movement toward economic regionalism or regional trade agreements (RTAs), which accelerated in the mid-1980s, produced a significant impact on the shape of the world economy. This new regionalism differed in fundamental respects from an earlier regional movement in the 1950s and 1960s; it had much greater significance for the world economy. The earlier movement, whose only survivor is the European Union, was limited largely to trade and just a few other areas. The new regionalism is more global in scope and involves integration not only of trade but also of finance and foreign direct investment.

Previously, initiatives toward development of regional free trade areas had been followed by new rounds of multilateral trade negotiations. For instance, the European Single Market Act (1986) triggered the "new regionalism" and stimulated development of other similar efforts. The goal of the movement toward regional integration in Western Europe became *political unification* as well as creation of a single unified market. In Western Europe and elsewhere, trade has become increasingly regionalized, and this development has caused a concern that the international economy may be moving in the direction of regional economic blocs. This expanding movement toward regional integration can be characterized as a response to what political scientists call a "security dilemma", in which each regional movement attempts to enhance its own bargaining position vis-á-vis other regions.

In the early 1980s, European reticence to join the American-initiated Uruguay Round of trade negotiations, fear in the United States that Europe was turning inward, and impatience with the slowness of the General Agreement on Tariffs and Trade (GATT) negotiations led to the American decision to support North American economic regionalization. Once launched, the slow and drawn-out Uruguay Round as well as the regional movements in Western Europe and North America undoubtedly also contributed to the spread of regional trade agreements elsewhere in the world. Many nations, fearing that the Round would never succeed or that they would be shut out of other regional arrangements, initiated regional efforts, and regional trade agreements proliferated. By the late 1990s, there were approximately 180 regional agreements, and almost all members of the World Trade Organization (with the notable exception of Japan, Hong Kong, and Korea) were included in one or more formal regional arrangements. This unit is devoted to this important development in the field of IPE. Accordingly the unit is divided in to two sections. In the first section we will discuss the meaning, nature and the logic of regional blocs. And in the second section we will discuss the implication of the development of a multiplicity of regional blocs to the global economic and political order and the challenges ahead of this organization achievement of political and economic goals.

Unit objectives

Dear learner, at the end of this unit you should be able to:

- Explain what a regional integration
- Identify and discuss the economic and political logic of regional integration
- Explain the implication of the development regional integration to the global political and economic order

✷Pre-test Questions

- What do you think is the difference between a free trade area and a custom union?
- What is the difference and similarity between the EU, AU, COMESA and NAFTA
- Who do you think is the best example of a successful regional integration schemes in the world
- Why do you think states create regional integration schemes

Section One: The Nature and the Logic of Regional Integration

✪ Section Overview

Dear distance learner, welcome to the first section of the political economy of regional integration. As we have mentioned in the introduction regional integration has become one of the most significant developments of IPE in the 1980's as sates in different parts of the world forged regional blocs for variety of reasons. The focus in this section is to acquaint you with the nature and the economic and political logic of regional integration.

Section objectives

Dear distance learner, by the end of this section you should be able to:

- Define regional integration
- Identify and explain the variety of theoretical (economic and political) perspectives on regional integration
- Identify and explain the various stages (levels) of regional integration

1.1 The Conception of Regional Integration

? Dear learner, what do you understand by regional integration?

Regional integration is a concept used, generally, to mean a set of policies by one or more states designed to promote the emergence of a cohesive regional unit, which dominates the pattern of relations between the states of that region and the rest of the world, and which forms the organizing basis for policy within the region across a range of issues.

Conceptually, scholars make a specification and difference between ‘regionalism’ and ‘regionalization’. Although sometimes they are used indistinctly, they have different meanings. The conventional understanding is that while ‘regionalism’ is conceived as a ‘project’, ‘regionalization’ is ascribed to a ‘process’.

From the International Political Economy point of view, “regionalism” would include the political initiatives of government members in order to strengthen political and economic cooperation among states and actors of a given region. “Regionalization” would mean the whole integration process that takes place inside one or several geographic regions. It implies the strengthening of relations among state and non-state actors of the region, but, setting apart from regionalism, neither the political aspect nor the institutional character of these processes are always present or necessary in the academic discussions.

The academic approach to the regional integration has come, mainly from liberalism and its concern with cooperation and its connection with economic explanations. It is understood as a process by which group of nation-states agree to ignore their own national boundaries; at least for some, but not necessarily limited to, economic purposes there by creating a larger and more tightly connected system of markets. Increasing economic interdependence among national economies are indeed very important; yet, as scholars have repetitively pointed out, the major economic tendency of the post–World War II era has been to restore the level of international economic integration that existed prior to World War I.

1.2 Theoretical Basis of the Logic of Regional Integration

? Dear learner, why do you think states form regional economic and political blocs?

In the contemporary world, virtually every nation is a member one or another regional economic bloc due to a combination of reasons. Every regional arrangement represents a cooperative effort of individual states to promote both their national and their collective economic and political objectives. The diversity of regional arrangements makes broad generalizations and overarching theories or explanations of regionalism impossible. One cannot confidently assess these regional efforts or predict their effects upon the world economy. It is nonetheless desirable to present a summary and critique of the principal attempts by economists and political scientists to develop theories or explanations regarding economic and, to a lesser extent, political regionalism.

By-and-large, economists have been interested in the welfare consequences of regional arrangements for members and nonmembers, and political scientists have been more concerned with ways to explain economic and political integration. While writings thus far have provided important insights into many aspects of economic regionalism, they leave many questions unanswered. Later, as the international economy has become more closely integrated, regional groupings have been justified more politically. It is argued that states have increased their cooperation in order to strengthen their autonomy, improve their bargaining positions, and promote other objectives. Economic regionalism is an important response by nation-states to some shared political problems and to a highly interdependent and competitive global economy. Hence, we have two broad sets of theories relating to the notion of regional integration: economic and political.

1.2.1 Economic Theories

? How do you think economists justify the formation of regional economic blocs?

Integration of formerly self-contained economic areas into larger economic entities has been important in modern history. The modern era has been characterized by integration of small and relatively distinct territories into larger nation-states and into national economies surrounded by trade barriers. The conventional wisdom of the *economics* profession—based on the theory of comparative advantage—had been that regional agreements were beneficial to members and nonmembers alike, and that they produced much the same consequences as did global trade liberalization.

In other words, the economic gains to both members and nonmembers were similar to those produced by free trade and included the benefits of specialization, improved terms of trade, greater efficiency due to increased competition, and increased factor flows among members.
In the idiom *economics*, integration produces what are known as *static efficiency* gains and *dynamic efficiency* gains. The first gain is said to be the consequence of *specialization* of member nations in a particular economic engagement, in which redundancy and protective barriers that preserve inefficient industries would be eliminated, in the free trade zone. This second gain, often known as the *benefit of economies of scale*, arises from the creation of a larger and integrated market which promotes efficiency in certain industries whereby large scale and long run production is possible.

Economic analysis pointed out that a common external tariff would have trade-diverting as well as trade-creating effects. The initial or static consequences of an external tariff, say, around the European Common Market, would divert trade from foreign suppliers to suppliers located within the Common Market. However, the long-term or dynamic effects of a common market would lead to creation of a larger and wealthier European market that would benefit not only local firms but also the market’s external trading partners. Whether the trade-diverting or the trade-creating effects of a customs union would ultimately predominate was an empirical question that could be answered only from actual experience.

In general, economic analysis of integration was mainly based on the neoclassical theories of trade and economic growth that assumed perfect competition, constant returns to scale, and diminishing returns, new thinking about economic integration is based on economies of scale and other favorable consequences of integration within the region. This implies that firms within a regional arrangement can gain competitive advantages from which firms outside the arrangement are excluded. External barriers could also protect such firms from external competition and enable them to achieve economies of scale and international competitiveness as well. Regional trade barriers could enhance the bargaining position of local firms and governments in their dealings with outside firms and governments. Evidence suggests that such strategic advantages of economic regionalism have played a role—but not a determining role—in the movement toward European integration.

Nevertheless, the principal approaches that economists have taken in their efforts to explain regional integration or free trade areas arise from *neoinstitutionalism,* the *new political economy* and *Marxism.*

1.2.1.1 The Neoinstitutionalist Approach

The neoinstitutionalism approach assumes that international, including regional, institutions, such as those of Western Europe, are established to overcome market failures, solve coordination problems, and/or eliminate other obstacles to economic cooperation. These institutions create incentives for states to cooperate and, through a variety of mechanisms, to facilitate such cooperation. Although the new institutionalism provides valuable insights, it does not consider the political reasons for regional arrangements.

1.2.1.2 The New Political Economy

The New Political Economy [NPE] approach explanation emphasizes interest group politics and the distributive consequences of economic regionalism. It assumes that such regional trade arrangements as customs unions and free trade agreements have significant redistributive consequences that are usually harmful to nonmembers. The argument behind such assumptions is that they create both winners and losers among the members themselves. Indeed, economists frequently explain economic integration as resulting from efforts of domestic interests to redistribute national income in their own favor. This approach provides important insights into the domestic politics of economic integration but fails to explain the costly efforts by Europeans to achieve regional integration.

1.2.1.3 The Marxist Approach

Marxist analyses of economic and political integration tend to be another economic approach to an explanation of integration. For Marxists, economic integration in general, and the movement toward European economic and political integration in particular, are explained by the efforts of *transnational capitalist classes* to increase the scale of capital accumulation. Over the course of modern history, the requirements of capital accumulation have driven the world toward ever larger economic and political entities.

According to this point of view, technological developments and international competition are forcing the dominant European capitalist class to overthrow the narrow confines of national capitalism and forge a regional economy that will strengthen the international competitiveness of European capitalism.

In fact, other theoretical subject of interest to economists has been the theory of an *"optimum currency area" (OCA)*. This theory specifies the conditions necessary for establishment of a common currency within an economic region. This theory is of special relevance to the effort to achieve the European Economic and

Monetary Union (EMU). There is also a small literature on the "optimum regionalization" of the world economy; and attention is given to comparison of the political and economic consequences of a world containing two regionalized economies with the consequences of a world of three or more integrated regions. But, by-and-large, an important body of economic literature deals with the welfare consequences for nonmembers of such regional arrangements as customs unions (the European Common Market) and of free trade areas (NAFTA). And, economic theories have always tended to omit certain important political and strategic motives responsible for economic integration. Hence, economic theories alone do not provide a satisfactory explanation of regional integration due to the following factors:

(i) economic analysts generally assume that a political decision has been made to create a larger economic entity, and

(ii) Economists need only to analyze the welfare consequences of that decision and concern themselves with just a few aspects of the process of economic integration.

1.2.2 Political Theories

? What about Political Scientists?

Political scientists have had an interest in political and economic integration for a relatively long time; although before the movement toward European unity, no one attempted to formulate general theories or explanations of regional integration. They have emphasized institutional solutions to the problems of war and international political instability and have focused on the idea of federalism and political integration of the world. From the early postwar period on, the thinking of those interested in integration has been influenced by *federalism, neo-functionalism, neo-institutionalism, intergovernmentalism,* and *realism*.

1.2.2.1 Federalism

Throughout modern history, idealists have set forth schemes to solve the problem of war by building federalist institutions to which parties will consciously and voluntarily surrender their political autonomy and sovereign rights. In the twentieth century, Woodrow Wilson's proposal for a League of Nations, and the later establishment of the United Nations, inspired additional federalist solutions to prevent another great war. Following World War II, the World Federalist movement, whose appeal arose from its emphasis on persuasion, converting public opinion, and building of institutions, expanded. Although the federalist idea had some influence on the movement toward European integration, it appealed most of all to those interested in the global level.

Despite its intellectual appeal, federalism has never proved to be a successful route to political integration, and its successes have been achieved only under unusual political circumstances. The few examples of successful federal experiments have been motivated primarily by national security concerns. Indeed, the two most successful federal republics, i.e. Switzerland and the United States, were created in response to powerful external security threats. And in the United States, full political and economic integration were attained only after the victory of the North over the South in the Civil War. The German federalist state resulted from conquest by one nation (Prussia) of other German political entities.

Historically, political integration of independent political entities has resulted from military conquest or dynastic union, and neither of these methods will necessarily lead to creation of an integrated economy.

1.2.2.2 Functionalism and Neo-functionalism

The theory of neo-functionalism had its roots in pre–World War II functionalist theory that had appeared in response to the failure of the League of Nations to maintain the peace after World War I. Collapse of the League made people aware that something more than voluntary federalism was needed to ensure world peace. The British social democrat David Mitrany took up this challenge and systematically set forth his functionalist theory as a solution to the problem of war in his highly influential monograph *A Working Peace System* and other writings. According to Mitrany, modern economic, technological, and other developments made political integration of the world possible and necessary.

Inspired by Mitrany's insights, Ernst Haas developed what he called "*neo-functionalism*" and applied this theory to both international institutions and the process of European integration. He believed that modern democratic and, especially, welfare states required *rational management* of the economy and centralized technocratic control. As new functional arrangements were put into place, due to the complex technical problems that individual competing states could not deal with effectively, the realm of independent political action, and hence also of international conflict, would become more and more circumscribed. For this reason, states would learn the advantages of peaceful cooperation, and the importance of political boundaries would diminish. Political integration of the world would thus result from economic and other forms of international cooperation.

Neo-functionalism argued that economic, technological, and other developments during the twentieth century have driven peoples and nation-states toward peaceful economic and political integration at both the regional and global levels. Technocratic management of an increasingly complex and integrated global economy and social system had become imperative. The problem of war could be solved and the war-prone system of nation-states could be escaped through international agreements in such specific functional or technical areas as health, postal services, and communications. Even though the political system remained fragmented into jealous and feuding nation-states, such functional and technical international institutions were feasible because the world has increasingly become highly integrated both economically and physically by advances in communications and transportation. As functional international institutions succeeded and promoted social and economic welfare, they would gain legitimacy and political support and would overtime triumph over the nation-state.

? What are the differences between functionalism and neo-functionalism?

The neo-functionalist theory, like functionalist theory, believed that economic cooperation would lead to political integration at either the regional or global level. The idea that economic and technological forces are driving the world toward greater political integration is at the core of neo-functionalism. Forces leading to economic and political integration are embedded in the modern economic system and tend to be self-reinforcing, as each stage of economic integration encourages further integration.

Neo-functionalism assumes that economic and other welfare concerns have become, at least are becoming, more important than such traditional concerns as national security and interstate rivalry. Underlying this assumption is a belief that industrialization, modernization, democracy, and similar forces have transformed behavior. The theory assumes as well that the experience of integration leads to redefinition of the national interest and eventual transfer of loyalty from the nation-state to emerging regional or global entities.

It is worth noting several ways in which neo-functionalism modified functionalism. Whereas functionalism assumed that conscious political decisions would accelerate political integration, neo-functionalist theory assumes that, once the process of economic and technical integration has been launched, unanticipated consequences, spillovers from one functional area to another and the effects of learning will propel the process toward eventual political and economic unification.

One of neo-functionalism's core propositions is that the logic of functional spillovers would push political elites inevitably from economic cooperation toward political unification. Neo-functionalism concentrates on the process of regional integration itself and, unlike economic theory, does not attempt to evaluate explicitly the economic welfare consequences of regional integration. Yet, there is an unstated assumption that economic and political integration are beneficial to members and nonmembers alike.

Since scholars have recognized that functionalist and neo-functionalist thinking about regional integration has proved inadequate, new approaches such as neo-institutionalism and intergovernmentalism have influenced the writings of political scientists interested in economic and political integration.

1.2.2.3 Neo-Institutionalism and Intergovernmentalism

Neo-institutionalism emphasizes the role of institutions in solving economic and other problems; it maintains that institutions could help ameliorate market failures and solve collective action problems in economic and political integration. The most prominent scholar in this school of thought is Robert Keohane, who along with others has emphasized the need for international institutions to deal with market failures, reduce transaction costs, and counter other problems. Scholars argue that international institutions (or regimes) assist states to solve *collective action problems*, promote cooperation through facilitation of reciprocity (*tit-for-tat* strategies), and link various issue areas.

And, regional international institutions are assumed to increase the incentives for states to solve their disputes and cooperate with one another. Although this position has been very influential in the development of thinking about regional institutions, it has not led to a specific theory of economic and political integration.

The most significant approach by political scientists to economic and political integration since neo-functionalism is intergovernmentalism. This approach, derived from neo-functionalism, neo-institutionalism, and other earlier theories of political integration, shares with neo-functionalism an emphasis on economic interests as the principal driving forces of regional integration.

Like neo-institutionalism, it stresses the importance of international, i.e. regional, institutions as a necessary means of facilitating and securing the integration process. However, intergovernmentalism differs from earlier approaches in its concentration on the central role of national governments, on the importance of powerful domestic economic interests, and on bargaining among national governments over distributive and institutional issues.

Intergovernmental theory argued that the broad lines of integration reflect three factors: patterns of commercial advantage, the relative bargaining power of important governments, and the incentives to enhance the credibility of interstate commitments. Most fundamental of these was commercial interest. European integration resulted from a series of rational choices made by national leaders who consistently pursued economic interests—primarily the commercial interests of powerful economic producers and secondarily the macroeconomic preferences of ruling governmental coalitions—that evolved slowly in response to structural incentives in the global economy. When such interests converge, integration advances. Yet, political integration is not occurring, in some regions like North America. Because the North American nations have no political motive to integrate with one another as the nations of Western Europe have. Surely, the geopolitical concerns of the major West European powers should be given greater attention.

1.2.2.4 Realism

Although a number of realists have written on political integration, there is no generally accepted realist theory. However, the realist approach does emphasize the importance of power, national political interests, and interstate rivalries in the integrative process. Realism regards regional integration, especially political integration like that taking place in Western Europe, as a political phenomenon pursued by states for national political and economic motives. Realism, particularly *state-centric realism*, assumes that a successful process of economic and political integration must be championed by one or more core political entities that are willing to use their power and influence to promote the integration process.

The realist approach to economic regionalism also calls attention to several factors that limit peaceful economic and political integration. It stresses on the importance of relative gains and of distributive issues in state calculations; these inevitably make the type of long-term cooperation necessary to integration efforts very difficult to achieve. States, for example, are unlikely to willingly compromise their national security for economic gains in a regional arrangement; thus far, the European Union has experienced little progress in reaching agreement on common security or foreign policies.

In addition, the economic concessions required to achieve regional integration may be granted to allies but certainly not to potential adversaries. Therefore, economic and political integration may require a powerful leader that has an interest in and a capacity to promote a regional arrangement.

Empirical evidences reveal that economic regionalism, in general, has been a response by nation-states to shared political and economic problems. Economic regionalism has spread because nation-states want the absolute benefits of a global economy at the same time that they seek to increase their own relative gains and protect themselves against external threats to their economic welfare and national security. As the world economy has become more closely integrated, regional groupings of states have increased their cooperation in order to strengthen their autonomy, increase their bargaining position in disputes about distributive issues, and promote other political or economic objectives. Regionalization is a means to extend national concerns and ambitions rather than an alternative to a state-centered international system.

Concerns over distributive issues and worries over national autonomy reflect the belief of national political and economic leaders that economic competition must necessarily be a central concern in world politics. Furthermore, international economic competition necessitates large domestic markets that enable domestic firms to achieve economies of scale. In order to survive and prosper in an uncertain and rapidly changing world, individual states and groups of states are adapting to the evolving economic, technological, and political environment, as they have done many times in the past. In the 1990s, states have responded to intensely competitive and threatening globalization by forming or extending regional economic alliances or arrangements under the leadership of one or more major economic powers.

Economic regionalism has become an important component in the national strategies of the major economic powers to strengthen their respective domestic economies and their international competitiveness. They attempt to achieve at the regional level what they are no longer able to achieve at the national level.
Political scientists have also studied the effects on economic and political integration of such factors as the pressures of domestic economic interests and the interests of political elites. They have emphasized the importance for domestic groups of the distributive consequences of integration, noting that winners support integration and losers oppose it. It has also recognized that political leaders will be guided by the consequences of integration for their own political survival. And, that domestic interests and institutions may facilitate or discourage integration. Many writings produced by political scientists in this area are very similar to those of economists. Literatures on this subject undoubtedly supplement explanations that focus on the international level, yet they had not been developed into a coherent theory or approach to economic and political integration.

In all cases, however, it would be worthwhile to note that there is no single logical explanation for the regional integration. Albert Fishlow and Stephan Haggard, on their part, have made a useful distinction between market-driven and policy-driven regional integration; certainly both *political* and *economic* considerations are involved in every regional movement. While some countries do it to protect themselves against giant economies with which they can’t compete on equal terms in international trade; others look it as a way out to overcome the negative impacts of the prevailing international order. However, the relative importance of economic and political factors differs in each. Whereas the movement toward integration of Western Europe has been motivated primarily by political considerations, the motivation for North American regionalism has been more mixed, and Pacific Asian regionalism has been principally but not entirely market-driven. Attainment of such political objectives as ending French-German rivalry and creating a political entity to increase Europe's international standing and strengthen its international bargaining position has been of vital importance in European integration. North American regionalization, on the other hand, has been primarily market-driven; establishment of the free trade area reflected the natural integration of the three North American economies (Canada, Mexico, and the United States) by market forces. However, some political motives, such as strengthening North America's position vis-a` -vis Western Europe and reducing illegal Mexican migration into the United States, have also been factors. And in Pacific Asia, although market forces have been the most important factors in integration of the economies, political considerations and Japanese policies have also played significant roles.

1.3 Forms and Institutional Arrangements of Regional Blocs

? Dear student, how do you think is regional blocs are classified?

As mentioned above, *regionalism* as feature of international political economic order has spread in response to varying political, economic, and technological developments. Usually, regional integration leads to a considerable economic linkage among countries at multi-lateral, regional, sub-regional and bi-lateral levels. It is characterized by removal of barriers, from minimal to high levels of integration that prohibit or hinder the movement of goods, services, labor and capital. It also requires a conduct of common decision making grounds, in a way of pooling together, in political and economic realms on various scales.

Ali M. El-Agraa et al. [1994] provide a useful discussion of the various types of regional integration in their work entitled: *The Economics of the European Community*. These arrangements include the following in order of the stage of integration:

(1) *Free trade area*: This prevails when nations forming integration agree to eliminate internal barriers for goods and services amongst themselves in that particular area, i.e. members of the regional entity eliminate all trade restrictions against each other's goods; an example is the North American Free Trade Agreement (NAFTA).

(2) *Customs union*: Comes into being when the concerned countries have in common an external tariff in addition to having an element of above mentioned free trade arrangement. In this case, although similar to a free trade area, participating countries adopt uniform tariffs and other trade restrictions vis-a` -vis

countries outside the union; the most prominent example was the European Economic Community or Common Market created by the Rome Treaty (1957).

(3) *Common market*: Extends a customs union to include the free movement of the factors of production (goods, services, people and capital). In other words, a common market adds to the above two, removal of barriers not only goods and services but also labor and capital free mobility without any restriction.

(4) *Economic union*: The highest form of economic integration incorporates the previous stages of integration and adds monetary and fiscal policy harmonization, laying the basis for a common economic policy; the only example is the movement toward European economic integration.

(5) *Political Union:* Moves beyond economic union to supranational decision- making beyond the purely economic; a political union is the ultimate goal of the movement toward European unity.

It has to be noted, however, that even though economic regionalism has become a universal phenomenon, regionalism has also assumed quite diverse forms. In addition to the differing mix of political and economic goals, regional arrangements vary in their institutional form. For example, whereas Western Europe is attempting to create an integrated political and/or economic entity, has erected an external tariff, and has become highly institutionalized, Pacific Asian regionalization has no external tariff, a very low level of institutional development, and every economy in the region has retained high tariffs. North American regionalism stands somewhere between the other two. The North American Free Trade Agreement [NAFTA] created a free trade area without an external tariff, does not have a common market, and has only a few formal institutions. The movement toward greater unity as Europe seeks to achieve both economic and political integration is the only example of what scholars call "deep regional integration". Therefore, with the triumph of the market, economic logic and the relative efficiencies of national economies determine the distribution of economic activities and *wealth*, and, of course, of *power* around the world. The advent of free trade areas such as the North American Free Trade Area (NAFTA) and customs unions like the European Union (EU) provides a good example in this regard of the political economy of international trade. Regional trade agreements like NAFTA and the EU frequently use economic tools to achieve political goals.

After half a century, i.e. by the close of 20th Century, the European Union has become a genuine 'federation' which meant far more than a common market. Because, it depicts a typical feature of supra-nationalism via its institutions namely: the European Court of Justice [ECJ], European Parliament [EP], European Council, etc. The success of EU today is attributed to the resort of members to intergovernmentalism or supra-nationalism.

Besides, the prevalence of European political parties in many countries enhanced the demand of union and integrity, laying the basis for the formation of EU. Notwithstanding the political heterogeneity, the EU was built on some common values like anti fascism, anti- Nazism, etc. But more than anything else, the economic interest (i.e. that of making enormous single market), and political interests behind it were the important driving factors. One of the political goals of European economic integration, for example, was to strengthen the western Cold War alliance.

Across the Atlantic, formal negotiations toward formation of a North American Free Trade Area (NAFTA) began in June1990, when the USA President G. Bush and Mexican President Carlos Salinas de Gotari signed, in a joint statement endorsing, the idea of comprehensive agreement between the United States and Mexico. Negotiations took place under six major headings: market access, trade rules, services, investment, intellectual property, and dispute settlement (using a mechanism modelled on the 1988 U.S.A -Canada free-trade accord).

This resulted in the progressive elimination of barriers to the flow of goods, services, and investment, as well as the strengthened protection of intellectual property rights, would be a catalyst for growth in all three nations. North American Free Trade Agreement [NAFTA], which came into effect on January 1, 1994, mainly affects trade between Mexico and Canada or Mexico and the United States. NAFTA, among other things, promised to eliminate trade and tariff barriers between the signatories over a period of 15 years and create a single market of hundreds of millions of consumers.

In fact, NAFTA was also meant to achieve some political objectives. One of the political goals of NAFTA was to stabilize and strengthen Mexico's democratic system. The economic benefits of regional free trade are intended to compensate states and their citizens for the loss of sovereignty and other political costs they may bear in forming a regional bloc.

On the Asian continent, the SAARC (South Asian Association for Regional Cooperation) was already established declaring a regional free-trade zone to bolster the economies of its member nations: India, Nepal, Bangladesh, Bhutan, Pakistan, Sri Lanka, and the Maldives. Another Asian group, committed itself to free trade, and decided to establish a permanent project promoting regional cooperation and growth is the ASEAN (Association of Southeast Asian Nations) belonging to six countries: Singapore, Malaysia, Thailand, Indonesia, the Philippines, and Brunei. The Ministers and national leaders of members of ASEAN expressed an interest in reducing or eliminating tariffs within the region on a wide range of goods.

In 1992, the trade between the so-called Pacific Rim countries and the United States has also become significant. The fledgling Asia-Pacific Economic Cooperation (APEC) forum consisted of the United States, Canada, and 13 Pacific and East Asian nations. East Asian governments also moved closer toward creation of the East Asian Economic Caucus, a proposed Asian regional group that would not include the United States, Canada, Australia, or New Zealand.

With the increasing pressure of economic competition from international trade blocs in North America, Europe, and Asia, the achievement of economic and political unity on the African continent remains a viable and urgent quest. One of the strategies for addressing the problems of Africa has notably the formation of regional cooperative groups. Examples of these include: the ECOWAS (Economic Community of West African States), the COMESA (Common Market for Eastern and Southern Africa) and the SADC (Southern African Development Community-formerly the Southern African Development Coordination Council), which are regarded as the major trading blocs that have played significant roles in regional economic integration in Africa.

From the aforementioned regional organizations, so far, only ECOWAS has emerged to be meaningful. ECOWAS is a regional organization set up to encourage economic, social, and cultural development in West Africa. Founded in 1975 by the Treaty of Lagos, ECOWAS began operation in 1977. ECOWAS is administered through a secretariat, which is based in Lagos, Nigeria. Since its inception, ECOWAS has moved to liberalize trade by gradually reducing restrictions on the movement of goods, services, and people between member states. It has also improved communications and transport within the region. Some member governments, however, have been slow to implement agreed-upon policies at a national level and to pay their contribution to community funds.

Besides, ECOWAS played a significant military role in the region during the 1990s. The organization set up mechanisms in 1990 to mediate disputes between its members, all of whom are pledged to “mutual nonaggression”. In the same year the ECOWAS Monitoring Group (ECOMOG), a peacekeeping force, that was practically successful in the negotiation of a peace treaty and the setting up of a transitional government in Liberia, ending the bloody civil war in1994.

Activity – 1

1. What are the basic differences between political and economic theories of regional integration?

____
____
____

2. Identify and explain the major stages through which regional integration schemes pass through to forge a complete political union?

____
____
____

Section Two: Regionalism and the Global Order

Section Overview

In the first section of this unit you were introduced to the nature and logic of regional integration, the various stages through which regional integration may pass through. You have also been acquainted with the variety of theoretical perspectives on the logic and the nature of regional integration. This section is in a way is a continuation of the first section as it attempts to build on the forgone discussion with special emphasis on the implication of this regional integration schemes on the global political and economic order.

Section objectives

Dear distance learner, by the end of this section you should be able to:

- Identify and explain the implication of the multiplicity of regional integration schemes on the global and economic and political order
- Discuss the challenges facing regional integration schemes in achieving the ideals of their creators

2.1 Regional Integration: Way to a Global Order?

? Dear learner, what do you think is the implication of the multiplicity of regional blocs for the global political and economic order?

A great dispersal of economic power has marked the post-Cold War world order. Different layers and categories of trade relationships have continuously been developing. This web of relationship has incorporated countries of the South and North into the global economic order in various ways and on different schedules. Hence, much of the impetus for regionalism is argued to the result of two major global divisions. The first division was philosophical and ideological one between the market oriented industrialized and state controlled oriented. The second division was military political that symbolized the Iron-curtain in Europe. It is the removal of the barriers during the 1980s that allowed geography to play a crucial role in determining the flow of international trade and investment.

Regionalism at the turn of the twenty-first century entails increased regionalization of foreign investment, production, and other economic activities. Compared to the earlier regional movement of the 1950s and 1960s (the European Economic Community is the only surviving example of that movement), the new regionalism has much greater significance for the global economy. The movement at the beginning of the twenty-first century is nearly universal; the major economies, with a few exceptions that include China, Japan, and Russia, are members of a formal regional arrangement.

At any rate, regional integration agreements [RIA] are serving as key forces in the prevailing global order. However, regionalization is not an alternative to the nation-state, as some believe, but rather embodies the efforts of individual states to collectively promote their vital national interests and ambitions. These developments have made the governance of the global economy a pressing issue. Effective and legitimate governance requires agreement on the purpose of the international economy. Today, while many critics challenge the emphasis on the importance of free trade and open markets, the new era of trade blocs continue to be characterized by bilateral deal making and increased protectionism that the purpose of governance should be to promote unrestricted free and open markets.

2.2 Challenges of Regionalism

? Dear learner what are the challenges facing regional blocs to achieve their set political and economic objective?

In theory, regional blocs create both political and economic benefits. At the same time, however, there are political and economic costs. And let us see these challenges in view of the general challenges of regional integration. *Politically* there is the problem of the democracy deficit. As more and more policy decisions are made at a supra-national scale, i.e. superior level to that of the nation-state, the link between citizens and policy is necessarily weakened, which may weaken the legitimacy of government generally.

Economically there is the problem that regional free trade is not always consistent with global free trade. Regional trade blocs may experience trade diversion where production shifts from a more efficient producer outside the regional bloc to a less efficient producer within the bloc. This inefficiency wastes scarce resources and reduces global welfare, according to the economic analysis. Thus freer trade is not necessarily the road to free trade.

There are costs of compliance often associated with regional integration. These include costs of changing the *legal* and *administrative* systems; costs of meeting the heterogeneous norms, costs of setting up new institutions, and costs of enforcement and so forth.

Activity – 2

1. What are the major challenges facing regional integration schemes in achieving the objectives of their creators?

____
____
____
____

UNIT SUMMARY

As we have discussed in the forgone sections, economic regionalism has become a means to increase the international competitiveness of regional firms. Various forms of economic regionalism (customs unions, free trade areas, and single markets) provide, to some extent, such advantages of free trade as increased competition and economies of scale while simultaneously denying these advantages to outsiders unless they invest in the internal market and meet member-country demands for local content, technological transfers, and job creation. Regionalism also facilitates pooling of economic resources and formation of regional corporate alliances. For all these reasons, regionalism has become a central strategy used by groups of states to increase their economic and political strength and therefore has become an extremely important feature of the global economy.

Such reasoning and efforts to increase international competitiveness have certainly been factors underlying the movement toward regional integration. In Western Europe, North America, and Pacific Asia as well as elsewhere, dominant powers and their allies within a region have joined forces to solve regional problems and increase their bargaining leverage in global economic negotiations. The countries of the European Union already participate in international trade negotiations as a regional bloc.

The Maastricht Treaty was intended to create a politically and economically unified European Union (EU) that would be the economic equal of Japan and the United States. In North America, ratification by Canada, Mexico, and the United States of the North American Free Trade Agreement (NAFTA) established a free trade area intended to create a strong North American, and perhaps eventually a Western Hemisphere, integrated economy. The third important regional movement, in Pacific Asia, has been led by a Japan determined to strengthen its regional and global position. Although this Asian Pacific movement has been made manifest primarily through bilateral trade and investment linkages between Japan and other economies in the area, an effort to increase political integration of the Asian Pacific region began with the founding of the Asian Pacific Economic Cooperation (APEC) community. These three movements toward regional integration and the interrelationships among them will have a profound impact on the nature and structure of the world economy for some time to come.

Self Test Exercises

Part I: <u>Choose the *Best* Answer from among the Given Alternatives [2% Each]</u>

1. Whereas, it is clear that membership in regional blocs create both political and economic benefits, it may, however, also has:
   A. the problem of the *democracy deficit* due to centralization of policy decisions although this enhances legitimacy.
   B. a consequence of inefficiency and wastage of scarce resources and reduces global welfare.
   C. a little costs of compliance.
   D. maintenance of national the legal and administrative.
   E. All

Part II- **TRUE/ FALSE[2% Each]**

2. Regionalization is not an alternative to the nation-state, as some believe, but rather embodies the efforts of individual states to collectively promote their vital national interests and ambitions.
3. In the academic circle, an approach to the regional integration has come basically from liberalism with its preoccupation in political explanations.
4. *One* of the benefits of regionalization is its static efficiency that accrues from the benefit of economies of scale with the possibility of long run production.
5. The FDI flow to Africa has been dominant in the industrial sector particularly in areas of extraction.

☑ Unit Checklist

Put an (X) mark in the boxes in front of the ideas you performed well and leave those you don't understand blank.

I can

- Explain what a regional integration ☐
- Identify and discuss the economic and political logic of regional integration ☐
- Explain the implication of the development regional integration to the global political and economic order ☐

If you have any doubt about your understanding of any of the above checklists don't hesitate to go back and refer the discussions in the sections

UNIT SIX

Political Economy of North-South Debate: Conflict and Cooperation

✪ Unit Introduction

Dear distance learner, welcome to the six unit of IPE. In this unit the focus will be on one of the relatively contemporary themes of IPE, the political economy of the relationship between the global North and South. The scope of IPE was no longer limited by the "traditional" questions and concerns of International Relations. It has developed according to set of complex factors, particularly the logic of contemporary politics and economics. During the Cold War, for example, geo-political distinctions are often made in international economic relations as East-West. The Cold War analysis of less-developed countries (LDCs) naturally focused on the East-West bipolar alliances and the place of LDCs in geopolitical strategy, which was termed by some, the strategy of the "*checkbook* and *chessboard*". The US and the Soviet Union, used aid (the checkbook) and other economic strategies to form alliances with LDCs that advanced their Cold War position (the chessboard). LDCs were strategic pawns in the Big Powers' cold war game.

But the geography of IPE, as shaped by international trade and capital movements, was also North-South, where North is shorthand for industrialized countries and South represents less developed countries, regardless of where they are situated on a world map. By-and-large, the work of postcolonial intellectuals and writers focused on nation-building, political decolonization and economic self-sufficiency as grounded in the political and social experience of the LDCs.

However, as international trade and international finance were increasingly expanding and the Cold War alliances strengthening (especially but not exclusively on the western side), IPE scholars pursued the impact of economic relations generally on LDCs. Hence, IPE expanded to encompass a critique of the mainstream economic development arguments. Yet, security and geopolitical issues were not excluded from this North-South analysis. They merely lost the privileged position that they enjoyed in traditional International Relations research.

The three perspectives stand out as milestones on the road to the IPE analyses of North-South relations are the works of Immanuel Wallerstein, *Dos* Santos, and Andre Gunder Frank. Immanuel Wallerstein's "Modern World Systems" theory (a point we have addressed in our previous course; African Politics and International

Relations), which looks at the interaction of the industrial and technological *core* with the less developed *periphery* and the intermediate *semi-periphery*, corresponds to the Newly Industrialized Countries. Core and Periphery have become integral elements of the IPE vocabulary.

Dependency theory, which is most often associated with the name Theotonio Dos Santos, examines the web of North-South relations and highlights the elements that keep the South dependent upon the North, to the North's systematic advantage. Finally, Andre Gunder Frank has written powerfully on a theory of Underdevelopment. It is argued that capitalism does not produce economic development in the South along the same lines experienced in the North. Rather, underdevelopment is produced, a situation where the structures of technology and industry do not achieve an independent existence but rather remain subservient to the North.

And, proper understanding of the two faces of world economic development requires a brief reconsideration of their history. To accomplish this task we have organized this unit in to two sections. In the first section, we will briefly summarize the background up on the north south relations are constructed, notably the colonialism and its legacy followed by a discussion on dilemmas of North-south relations and the notion of the New International Economic Order (NIEO). And the second section will be devoted to the discussion of the political economy of third world development.

Unit objectives

Dear learner, at the end of this unit you should be able to:

- Identify and Explain the dilemmas and controversies surrounding the North-South debate in IPE
- Explain the rationale behind the call for the NIEO
- Evaluate the debate on the possibility of development in the global south with in the guise of capitalism
- Critically analyze the implication of the emergence of the notion of the developmental state on the debate on development and underdevelopment

✹Pre-test Questions

- What do you think is the NIEO? Did it succeed?
- What is the developmental state?
- What are the most controversial issues in the political economy of north-south relations?

Section One: The North-South Dilemma

✪ Section Overview

Dear distance learner, welcome to the first section of the sixth unit of IPE. In this section the focus will be on the genesis of the north-south relationship which it has given which could be traced all the way from the slave trade through colonialism to the post colonial period and the dilemma and the debate it has entailed. In the first part of this section emphasis will be given to the legacy of colonialism and its continuing importance on the post colonial in the relationship between the ex-colonizer (roughly the global north) and the colonized (the south). In the second part we will discuss the nature of this relationship and the debate it has elicited and in the third section we will elaborate on the call for NIEO.

Section Overview

Dear distance learner, by the end of this section you should be to:

- Identify Explain the legacy of colonialism for the existing international economic order
- Explain the genesis of the notion of the "Third World"
- Explain the emergence and the significance of the Non Aligned Movement (NLM)
- Critically scrutinize the role and the significance of the Lome conventions in the North- south relations
- Explain the context in which the NIEO come in to existence
- Identify and describe the demands put forward by the global south in the NIEO
- Evaluate the implication of the call for the NIEO in the North-South relations

1.1 The Colonial Legacy and Nation-building

? Dear distance learner, why do you think is reference to colonialism and its legacy should be made in the discussion of the relations of the global North-South?

By the 1950s, many of the former European colonial empires and territories began to disintegrate. The disintegration of colonies unfortunately resulted in the birth of new-states in the formers' place in Asia, Africa and Latin America. These economically underdeveloped countries, or the LDCs as some prefer to call them, were considered as an entity with common characteristics, such as poverty, high birthrates, and economic dependence on the advanced countries. Until early 1960s, these new states were on the threshold of the new international order that was being shaped and reshaped by the Cold War.

This combination of conditions in Asia, Africa, Oceania and Latin America was linked to the absorption of the third world into the international capitalist economy, by way of *conquest* or *indirect domination*. The main economic consequence of Western domination was the creation, for the first time in history, of a world market. By setting up throughout the third world sub-economies linked to the West, and by introducing other modern institutions, industrial capitalism disrupted traditional economies and, indeed, societies of the "South". This disruption led to underdevelopment, as the economies of underdeveloped countries have been geared towards the needs of industrialized countries. They often comprise only a few modern economic activities, such as mining or the cultivation of plantation crops. Control over these activities has often remained in the hands of large foreign firms. The prices of third world products are usually determined by large buyers in the economically dominant countries of the West, and trade with the West provides almost all the third world's income.

Throughout the colonial period, outright exploitation severely limited the accumulation of capital within the foreign-dominated countries. Even after decolonization (in the 1950s, 1960s, and 1970s), the economies of the third world developed slowly, or not at all, owing largely to the deterioration of the "terms of trade", i.e. the relation between the cost of the goods a nation must import from abroad and its income from the exports it sends to foreign countries. Terms of trade are said to deteriorate when the cost of imports rises faster than income from exports. Since buyers in the industrialized countries determined the prices of most products involved in international trade, the worsening position of the third world was scarcely surprising. The only exception that can be mentioned here are the oil-producing countries (after 1973) which succeeded in escaping the effects of Western, domination of the world economy.

The worsening condition was exacerbated by class formation in the world that helped determine the political and economic position of states. These 'classes' of countries of the world are known as: *first world*- the USA and its allies of the industrialized and liberal democracies; *second world*- the Soviet Union and its allies; and the *third world*- former colonies of the west and vast majority of the world countries often known as the Least Developed Countries [LDCs].

As these new states began to build their own 'national identity', they faced a pressing and complex set of economic, political and social problems that exacerbated the already prevalent difficulty in creating a truly sovereign and genuine institutional apparatus. Hence, for the LDCs economic advancement has been crucial not only as an end in itself but also as a means to ensure a sustained and stable political system, independence and a defined cultural identity.

However, the envisaged *'development'* as Sunil Kukreja noted has had "two faces" for the LDCs. These are: the attractive face that promised an end to poverty and beginning of true independence; and the repelling face of exploitation, manipulation and continued subjugation.

These two faces of development in the Third World could be observed by looking at the four major forces that shaped the development dilemma in the early post- War period marked by decolonization. First, the colonial wounds were still fresh and deep. This implies that, colonialism and capitalism were surely viewed as the responsible for politico-economic "backwardness" the new nation-states.

Secondly, the way the LDCs dealt with the development problems was not a mere response to politically and economically exploitative colonial system, but also a resistance to a cultural domination by the West. In some cases, they have been cautious of even adopting Western approach to economic development.

Thirdly, the Cold War- proximity of the LDCs to USA, its allies and even historical connections to mother countries, or the Eastern bloc often determined the political and economic strategies that the former had to choose. Finally, or rather paradoxically, the success of developed nations had also provided a reasonable ground for many of the LDCs to follow their footsteps, or at least to adopt market-oriented prescriptions for economic development. These forces set the stage for the dynamics of the development process and the North-South relations for most part of the latter stages of the Cold War.

1.2 The North-South Dilemma

? Dear distance learner, how then do you think this apparently unequal relationship influenced the course of relationships between the entities?

Recognizing the fact that the LDCs were unable to significantly influence the working international system and its institutions, a number of countries, largely from the 'South', attempted to forge their collective identity. Politically, the birth of *Third World* brought the lack of economic development and prosperity in the LDCs to the foremost global agenda, while building their common position in the world order. Then after, the contrasting economic disparities between the best developed and least developed nations became a defining feature in the new international order, what latter came to be known as *the North- South dilemma.*

? How do you think the NAM come in to existence?

The 1955 conference of Afro-Asian countries held in Bandung, Indonesia, is regarded as the first step in forging that identity, and a genesis of what latter came to be considered as the a "southern perspective". Two nations whose social and economic systems were sharply opposed-China and India-played a major role in promoting that conference and in changing the relation between the third world and the industrial countries, capitalist and communist.

? Why do you think China?

It is because of the fact that the term 'Third World' was originally intended to distinguish the nonaligned nations that gained independence from colonial rule beginning after World War II from the Western nations and from those that formed the former Eastern bloc, and sometimes more specifically from the United States and from the former Soviet Union (the first and second worlds, respectively). For the most part the term has not included China.

? What do you think is the political significance of this movement?

The political emergence of third world, led by Jawaharlal Nehru of India, Joseph Marshal Tito of Yugoslavia, Ahmed Sukarno of Indonesia and Gamal Abdel Nasser of Egypt, even Emperor Haileselassie, *inter alia*, laid the basis for dialogue that subsequently led to the institutionalization of the Southern Perspective, i.e. the formation of the *Nonaligned Movement* [NAM] in 1961. As the NAM came to encompass many nations from as far as the Latin America, it appeared that NAM members are numerically dominant in the United Nations. But the group is diverse culturally and economically, and its unity is only hypothetical.

Nevertheless, the movement has served three basic purposes. First, it aimed to be the political arm of LDCs that helps them in addressing the initiatives against the impacts of neo-colonialism, particularly as far as Africa is concerned. Secondly, it was a vehicle that drives them outside the arena of the Cold War scenario; and thirdly, it was an instrument to promote the collective interests of LDCs.

Hence, as Sauvy noted the third world is '*nothing'*, and it wants to be "something". The term therefore implies that the third world is exploited, much as the third estate was exploited, and that, like the third estate (as in the French revolution) its destiny is a revolutionary one. It also conveys a second idea, also discussed by, that of non-alignment, for the third world belongs neither to the industrialized capitalist world nor to the Communist bloc.

As far as the economic prospect is concerned, the development that has occurred in the third world has not been distributed fairly between nations or among population groups within nations. Most of the third world countries that have managed to achieve substantial economic growth are those that produce oil. They have also shown their leverage after 1973 the OPEC cartel that succeeded in raising the price of oil quite dramatically. But, with increasing urgency, the problem of underdevelopment then became the focus of a permanent, although essentially academic, debate. Despite that debate, the unity of the third world remains hypothetical, expressed mainly by the platforms of international conferences.

? What about the importance of this movement in the north-south relations? What do you think is the Lome convention?

Same holds true in the North-South cooperation spheres. The relationship between the underdeveloped and the industrialized countries has continuously improved. One of the conventions that provided a framework of cooperation between the North and South, more particularly between the European Community (EC)—the EU's predecessor—and former British, Dutch, and French colonies in the developing world, was the Lomé Convention. Lomé Convention, first signed in February 1975 in Lomé (Togo) was an agreement trade and aid between the European Union (EU) and 70 African, Caribbean, and Pacific (ACP) countries. The agreement enabled most ACP agricultural and mineral exports to enter the EC free of tariff. In addition, the EC provided assistance to ACP nations to protect against fluctuations in the world prices of primary commodities of agricultural and mineral exports. It also committed $3.8 billion toward aid and investment in ACP countries. Subsequent renewals of the Lomé Convention, i.e. Lomé II, have steadily increased aid and investment expenditures, which amounted to $17.9 billion in 1995.

Most observers agree the Lomé Convention has lost its effectiveness in addressing problems of poverty and underdevelopment in ACP nations. The global trend toward liberalization of international trade and the moving away from trade preferences of any sort have undermined the special relationship between EU and ACP nations. While the goal of the Lomé Convention was to expand trade between ACP and European nations, the ACP's share of European markets has actually declined since 1975. ACP nations have also found themselves increasingly at odds with industrialized nations and other developing nations over the issue of preferential access to European markets. In the 1990s, for instance, Caribbean banana farmers feared that more open global trade would enable corporate plantations in Central America to flood European markets with cheaper bananas, with devastating effects on Caribbean economies. Negotiations in 1993 led to an agreement maintaining the Caribbean producers' preferential access. However, the controversy divided nations within the EU and led the United States, which represented corporate growers of bananas in non-ACP countries, to file a complaint with the World Trade Organization.

In response to these challenges, the European Union has essentially abandoned the tradition of a special relationship between EU and ACP nations. In 1995 negotiations with ACP nations and in subsequent statements, the EU has committed itself to a more pragmatic relationship based upon principles of free trade, open markets, private enterprise, diminished aid contributions, and tighter controls over these contributions. The 1995 negotiations between the EU and the ACP nations also tied aid more directly to a nation's quality of governance and respect for democracy and human rights.

Nonetheless, with the possible exception of few oil-producing countries with low populations, in the face of the economic crisis of the there did not seem to be much chance in the foreseeable future for any significant change in the relationship between the industrialized and underdeveloped countries. Nor did the prospects for economic development in the third world appear to be very bright: Between 1960 and 1980 half of the African countries had actually regressed. Almost the only countries to receive some of the capital needed for development were those lucky enough to have a significant amount of raw materials, especially oil, to export.

Disgruntled with the economic crisis of the 1970's and the consequent economic regress in many third world countries third world countries, LDC's called for a new international economic order using their superior number in the UN general assembly. The debate surrounding the call for the NIEO and the implication of the call and the consequent developments of the call in the North-South relations is the topic we are going to address in this section.

1.3 The New International Economic Order

? Dear distance learner, what do you think is the NIEO?

The *third world* membership in different international institutions is a reflection of urgent demand to foster their solidarity and momentum for the change in the international political economy. This is often attributed to the prevailing agreement among all international agencies that drastic action is required to improve conditions in third world countries, including urban and rural public work projects to attack joblessness and underemployment, institutional reforms essential for the redistribution of economic power, agrarian reform, tax reform, and the reform of public funding. But, in reality, political and social obstacles to reform are a part of the very nature of the international order and of most third world regimes. Hence, virtually all efforts of existing institutions and structures, have failed to solve the problem of underdevelopment.

The United Nations Conference on Trade and Development (UNCTAD) was established in 1964, spearheaded by 77 countries of the South, known as Group of 77 (G-77). UNCTAD served as a mechanism for dialogue and negotiation between the North and South in trade, finance and other area of economic development.

In UNCTAD I, the LDCs have proposed the establishment of the international trade organization to replace GATT. Under the initiatives of UNCTAD, the LDCs are said to have been able to gradually secure some concessions and preferential treatments, i.e. generalized system of preferences [GSP], on tariffs for their export to the developed nations. The UNCTAD conference held in New Delhi in 1971 suggested that one percent of the national income of industrialized countries should be devoted to aiding the third world. That figure has never been reached, or even approximated. In 1972 the Santiago (Chile) UNCTAD set a goal of a 6 percent economic growth rate in the 1970's for the underdeveloped countries. But this, too, was not achieved. The living conditions endured by the overwhelming majority of the 3 billion people who inhabit the poor countries have either not noticeably changed since 1972 or have actually deteriorated.

In 1973, the OPEC oil cartel, that raised the price of oil by 400 percent, helped enhancement of attention to the third world concerns by temporarily altering the global balance of political and economic power, as it jolted the developed economies. This critical event, by extension complicated the development dilemma. The OPEC leverage resulted in six special sessions of the UN General Assembly in the establishment of what is called the New International Economic Order [NIEO].

NIEO was essentially designed to facilitate the pace of development among the LDCs and change the unequal economic balance between the North and South. Unlike previous efforts, the NIEO was not seen as an attempt to fine-tune the existing institutions, but as an effort to evaluate the development issue on the top of the international agenda; changing the respective institutional structures and making them more conducive to LDCs development concerns.

The NIEO included the calls for:

i. Creation of Integrated Programme for Commodities [IPC] to stockpile and control the price of commodities in times of oversupply and scarcity
ii. Extension and liberalization of the generalized system of preferences [GSP]
iii. Development of debt relief programme
iv. Increasing the official development assistance from the North (rich) to the less developed South
v. Altering the pattern and process of decision-making in major IOs [UN, IMF and WB] in such a way to give more voice to the South thereby minimizing the control of these institutions by the developed North
vi. Enhancing the economic sovereignty of the LDCs *via* initiatives that ensure greater control of their resources; increasing access to Western technologies, ability to regulate multinationals and preferential trade policies that stabilize price of commodities and access to markets of the developed nations.

Its initial and subsequent proposals requested the change of world economic order to make it friendly to the perceived needs of the developing states. Working towards this goal, several commissions and reports have advocated the changes in the rules that govern international trade, monetary systems and other issues. More particularly, they advocated changes in international organizations- the UN, the World Bank and the IMF that would give the LDCs a greater chance to influence the management of the world economy.

? Dear student, do you think this plan will succeeded?

The attempt, however, did not succeed. The following reasons could be mentioned as reasons for the failure of NIEO. In the first place, despite the rhetorical and marginal differences in their positions, none of the developed economies made significant concessions. Western countries supported the US that led the resistance to the third world demand. Secondly, contrary to their statements, the OPEC members have been unwilling to put their power and wealth at the service of other Third World states. Instead they used their newly gained economic power to support their own national interests and have invested most of their financial surplus in the Western markets. Finally, the rise of petroleum price had a devastating impact on non-oil-producing countries, particularly those in the third world. The resultant global recession undercut the bargaining power of LDCs and blunted the demands for a new order.

History of NIEO demonstrates the fundamental dilemma of less developed countries attempt to change the operation of the world market economy and to improve their relative position. The dilemma is that these developing countries often used the nationalistic spirit, which frequently undermined their effort to cooperate amongst themselves and to form economic alliance against the developed world.

The LDC revolt led by the Group of 77 continued after NIEO against the major economic powers and their dominant position in the Bretton Woods institutions. In addition to a long list of specific economic demands, such as debt relief and greater access to ADC (advanced developed countries) markets, the Group of 77 wanted the Bretton Woods institutions to be placed under the authority of the UN General Assembly where the LDCs have a voting majority and could force the World Bank and other international organizations to implement their own economic agenda.

This assault on international liberalism, to use Stephen Krasner's formulation, was eventually defeated by the United States and other major economic powers. Subsequently, in the late 1970s and early 1980s, the huge debt crisis of many LDCs led to another revolt, but the LDCs were eventually forced to accept the dictates of the major powers. Hence, although the NIEO has failed to produce the desired reforms, it does not necessarily invalidate the LDCs grievances or make certain changes in the relationship between the North and South less desirable.

Activity – 1

1. What were the major reasons for the failure of the call for the NIEO?

____

____

____

____

____

Section Two: The Political Economy of Third World Development

Section Overview

Dear distance learner, welcome to the second section of the political economy of North-South relations. In this section the focus is on the political economy of third world development, which is the other side of the argument of the call for NIEO. The most important question in this regard is the possibility of third world development within the framework of the existing international economic structure which, it is argued, the west has created through colonialism. Another important debate in this area is the relative role of the state and the market in socioeconomic development. Most importantly, we will shed light on the contemporary debate on the notion of the developmental state.

Section objective

Dear distance learner by the end of this section you should be able to:

- Identify and explain the characteristics of the "developmental state"
- Evaluate the arguments made for and against developmental state

1.1 The Political Economy of Third World Development

? What do you think explains the development of what is often called "Asian tigers"? And what do you think is the implication of this for development theory?

Much of the north's resistance to the efforts of the south to restructure the IPE reflects the North's conviction about the functioning of the liberal model of development, which places emphasis on the market. Among both scholars and public officials, there are strong disagreements regarding the relative importance of the state and the market in economic development; these disagreements have been central to the conflict between the developed and the less developed countries. Throughout much of the postwar era, a debate has raged between the neoclassical proponents of reliance on the market and the proponents of state intervention.

In the early postwar period (1945–1970), development economics, which emphasized the role of the state, was preeminent. Development economists argued that developing countries required an activist government; moreover, they believed that the international community should play a central role in LDC development.

Then, during the 1970s and 1980s, the neoclassical belief in the free market triumphed both in academia and in international institutions, and the ideology of "neoliberalism" and the doctrine of "structural adjustment" became dominant in the International Monetary Fund and the World Bank.

In the late 1980s and early 1990s, the "theory of the developmental state" arose to challenge neoliberalism. Differing with the policy prescriptions of neoliberalism but consistent with development economics, the theory of the developmental state emphasized that the state should play the central role in economic development. The controversy between proponents of the "developmental state" and of neoliberalism has focused on differing interpretations of the rapid and extraordinary economic success of the Newly Industrializing Countries (NIEs) of East and Southeast Asia. Neoliberalism argues that the success of these economies has been due to their reliance on the market and the minimal role of the state in the economy. The theory of the developmental state, on the other hand, credits the central role of the state for the rapid industrialization of the East Asian economies.

This position gained many adherents among non economist scholars of economic development. Then, in 1997, the East Asian financial crisis shifted the weight of the argument to the neoliberal emphasis on the importance of the market and the dangers of state intervention in the economy. Proponents of the developmental state strongly disputed this assessment and argued that the crisis was caused by international economic and political pressures. And so the debate continues.
To a significant degree, the fate of the great mass of mankind located in LDCs will be affected by whether the state-centric or market- centric approach to economic development is ultimately dominant.

To understand the nature of this crucial debate about the best path to economic development, one must begin at its origins in the early post–World War II era. You have been introduced to this debate in your course Development Theories and Practices and hence we are not going to repeat that debate here for the want of time and space. Rather we will only concentrate on the notion of the developmental state.

1.2 Theory of the "Developmental State"

? What is the underlying theoretical basis of the notion "developmental state"?

It is Chalmers Johnson (1982) that used the term "developmental state" to analyze the whole process of industrialization of Japan. Developmental state is often conceptualized between open liberal economy and a central-planned model. It is, then, within this framework that Meredith Woo-coming (1991) described the theory of developmental state as an explanation for the East Asian socio-economic transformation. Developmental state, sometimes called a *plan rational capitalist system*, conjoining private ownership with the state guidance seems to be an interventionist state. Explicitly stated, the developmental state is an embodiment of a normative or moral ambition to use interventionist power of the state to guide investment in a way that promotes a certain vision of national economy.

A historical insight in to the subject matter hints that developmental state existed in Bismarck's Prussia and in Japan during the Meiji era. These governments followed state policy designed in development path favoring a state interventionism over a liberal open market; whether in the form of East Asian economies or what later became the continental European model of capitalist welfare state. However, it is the research on East Asian that prompted the theory formulation and allowed its implementation and scholarly debate and literature. Its roots, nonetheless, are drawn from the theory of mercantilism advocating a substantial degree protectionism and intervention of the state in the economy.

The major justification for the developmental state is that it is a hardly possible fact to achieve extensive development goals in an environment where authorities have very limited power in directing investment, regulation intensity and influencing institutions. In substantiating their argument, the advocates of the developmental state look into the success of United States and even the United Kingdom in the global economy. As to Andrzej Bolesta (2007), for instance, extensive positive changes in the USA socio-economic developments are by-end-large the consequences the interventionist policies of 19thc especially in the agrarian sector. In the case of UK, its colonial past is responsible for the capital accumulation and wealth expansion. Having obtained a sufficient wealth, these countries came to advocate liberal economic policy. Moreover, it is argued that the so called global economy is by no means liberal, as there are many trade barriers and powerful forces such as government of large economies and international corporations which have credible influence, for instance, on the price of goods by following certain policies.

? What was the role of state in the case of Asian Tigers?

The proponents of the developmental state theory maintain that the East Asian states were able to play a guiding role in economic development because of a number of unique domestic and international factors. In all these societies, the state has been relatively "autonomous". And, this typical political feature had facilitated, in most cases, the probability of the state to pursue policies free from public pressure. Yet, this state autonomy was deeply embedded in a society where the state worked very closely with business interests to promote rapid industrialization.

Besides, the Asian societies in general have a quite different pattern of socio-cultural system. Social values such as hierarchical obsequiousness, a tradition of hard work, and subordination of the individual to the community played a crucial role; celebration of Asian values also provided ideological support to the authoritarian regimes of the region. The national political economy was based on trust and subordination rather than Western-style compliance and accountability. Although these states were authoritarian, they also carried out important reforms and implemented policies favorable to economic growth and social harmony; for example, they promoted land reform, education, and income equality.

At the core of the developmental state and the reason for its outstanding success were close ties among government, local banks, and industry. These intimate relationships, which Wade calls *"alliance capitalism"*, encouraging private entrepreneurs that assisted government actions in line with rapid industrialization. It facilitated channeling bank capital into promising industries thereby promoted rapid industrialization. At the same time, domestic governments frequently restricted both foreign direct and portfolio investments by international firms and thus insulated their economies from disruptive external influences.

The theory of the developmental state argues that the governments of Taiwan, South Korea, and the other NIEs devised an array of incentives that encouraged private investment in strategic industries. These governments, *via* different techniques, played a key role in creating an entrepreneurial class, identified critical economic areas for development, and exposed priority sectors to international competition that forced them to become efficient.

These state policies encouraged development of an industrial and economic structure that would not have arisen merely in response to market signals. According to the theory of the developmental state, the policies of these governments deliberately got prices "wrong" in order to change the behavior of firms; they also used non-price means to alter firm behavior.

Development of these economies was also supported by a number of sociological and political factors, such as a hard-working labor force and only moderate levels of inequality. Market failure was assumed to be prevalent among these less developed economies, and market failure necessitated an active role for the state. Governing elites believed that their societies faced "collective action problems"; that is, they had to find a way to motivate members of their societies to work together. State policies were needed to bring private returns in line with public returns. States had to create an incentive structure to ensure that private entrepreneurs invested in those economic activities that would be the most socially beneficial. Elites also believed that government policies should anticipate the future comparative advantage of the economy and that industrial policy should lead rather than follow the market.

In addition to these domestic features, a number of international factors were of benefit to the Newly Industrializing Economies (NIEs). As Cold War allies of the United States, they received special treatment in American economic and other policies. National security concerns motivated Taiwan and South Korea, in particular, to place a high priority on rapid economic development. Moreover, as some writers have pointed out, Japanese imperialism had left a legacy of physical infrastructure, an educated population, and effective institutions that favored economic development. Another very important factor was that these economies were able to pursue an export-led growth strategy because of the global free-trade environment.

Although this system produced liabilities disproportionate to their assets in the larger enterprises such as the South Korean *chaebol*, the system worked very effectively and was stable as long as local governments controlled domestic financial markets and the capital account, a situation that changed dramatically in the 1990s and was a significant factor in the post-1997 East Asian financial crisis.

On the other hand, according to the World Bank [1993] *World Development's Report,* which found that "there had been no East Asian miracle," the performance and the rapid industrialization of these economies is said to be the consequence of the following factors. These are:

(1) Prudent and market-conforming *macroeconomic policies* such as getting prices right and allowing domestic prices in line with international prices, encouraging industries with a natural comparative advantage to flourish there by keeping government deficits down or even reduced accumulated deficits, minimizing inflation, and holding foreign debt to modest levels;
(2) maintenance of *higher levels of savings and investment* that greatly facilitated rapid capital accumulation (accounted for 60 to 70 percent of the growth) that absorbed 7 to 10 percent of Gross Domestic Product (GDP) and *harder working* and *more skilled workers* than did other LDCs; and
(3) The *export push* or *export-led growth strategy*.

Focus on foreign markets promoted economic efficiency and accelerated introduction of foreign technologies leading to increased productivity has been another reason for their success.

While very critical of the "mystics," the theory of endogenous growth, and the idea of the developmental state, the Bank in its Report acknowledged that industrial policy and other forms of state intervention might indeed have assisted the process of economic development. Its argument is quite negative about the efficacy of state intervention, and attributed the success of these economies to the "Solow model" of economic growth based on "factor accumulation", neither to the state intervention nor the theory of "endogenous growth".

The *World Development Report*, based on such findings, described the theory or model of economic growth used to explain East Asian economic success as *functionalist* and concluded that a developing country would be successful if it carried out specific mutually reinforcing functions. Economic growth in these economies had been rapid and persistent, and the benefits of economic development had been broadly distributed throughout the societies.

For Latin America and other industrializing countries, the ultimate attractiveness of the theory of the developmental state is that it appears to be the appropriate means for combining economic development with political independence. Economic development and industrialization have never been considered ends in themselves

The ultimate goal of developing economies has always been to achieve economic autonomy and political independence. In a world of highly concentrated market power, states desire to control their national economies as much as possible and do not want their position in the international division of labor to be determined solely by the free play of market forces. Despite the strong support in many LDCs for the theory of the developmental state, most neoclassical economists reject it.

1.2.1 The Future of Developmental State: An Alternative Path of Development?

? Should developing countries like Ethiopia pursue this strategy?

To determine once and for all whether economic growth is better explained by factor accumulation of neoclassical theory and World Bank orthodoxy, or by technological advance (exogenous theory- where the role of the state in economic growth is negligible) and productivity growth (endogenous growth) theory, or the idea of the “developmental state,” to date remains to be a hard-hitting task among scholars.

According to the prominent Western interpretation, the East Asian developmental state contained the seeds of its own destruction. In the summer of 1997, the East Asian economies suffered a severe blow when a serious financial crisis and subsequently a much more general economic crisis brought the East Asian miracle to an abrupt halt. By the summer of 2000, the stricken nations had rapidly recovered from the crisis and its consequences. Those characteristics of the Asian model of economic development that have been credited with the extraordinary success of these economies and their rapid industrialization were alleged to be the very ones that led to the financial crisis and to subsequent economic disaster. This government-manipulated system encouraged questionable overinvestment, especially in particular economic sectors, by appearing to guarantee investors, at least implicitly, that their investments were not at risk. In this way, the developmental state created moral hazard that ultimately led to the crisis.

Proponents of the developmental state reject the above analysis and instead blame the crisis on the pernicious behavior of international financial markets. As had happened many times before, investors became caught up in a frenzy of investment in these "miracle economies." The excitement surrounding the possibility of "easy money" caused investors to throw caution to the winds and ignore such obvious signs of impending trouble as the large number of short-term liabilities that had been assumed by East Asian borrowers. The huge investments in the region, well above rational profit expectations, were driven by the irrational euphoria of international investors. In addition, the premature liberalization of financial markets and capital accounts (freedom of capital movements) in these countries (for which the United States bears a large responsibility) must be assigned much of the blame.

And, thus, the controversy over the developmental state continues. Recently, however, redefining the concept of developmental state by the students of the school has yielded another notion "democratic developmental state". The coinage of the term "democratic developmental state" implied to refer to the necessary state structure to transform the prevailing political and socio-economic landscape of the developing countries.

The concept of democratic developmental state has been defined by Omano as the state that not only embodies the principles of electoral democracy but also ensures citizens participation in development and governance processes. This takes us away from the anti-state conceptions of participation and developmentalism that completely marginalize the state as non-governmental organization, the private sector and local communities proceed almost surreptitiously with addressing of issues of poverty and development without the encumbrance of the state. In any case, economic development is dependent on a society's getting its *political* as well as its *economic* fundamentals "right." Without the former, such characteristics of the latter as openness to trade and sound macroeconomic policies cannot work because social norms, institutions, and customs determine how economic inputs will be used and whether success will in fact be forthcoming

Activity – 3

1. Briefly summarize the debate between the neo-liberal school of thought and the proponents of the developmental state on the relative role of the state and market in Asian-tigers.

UNIT SUMMARY

The international community has not yet come to terms with the immense problems of economic development. For over half a century the development of fro third world countries has their foremost challenge. Whether or not a development a new regime, the restructuring of the international economic order, is a possible or appropriate solution may be is a very difficult question to answer. In an era of neoliberalism with stress on the free market, the development of a new international economic order seems to be out of the question. On the other hand, free trade and economic openness do not by themselves constitute an adequate solution to the problem of underdevelopment or to the problems of the transition economies. A compromise must be found somewhere between the two extremes of abandonment of neoliberalism and total reliance on the market.

Self test exercises

Part I: Choose the *Best* Answer from among the Given Alternatives [2% Each]

1. The two faces of *development*, for LDCs in the post war era were apparently manifested in:
    A. Decolonization and politico-economic "backwardness" of the new nations.
    B. Dealing with development problems also meant a resistance to a cultural domination by the West.
    C. Cold War- proximity of the LDCs to East or West that were often determined by political and economic strategies.
    D. The assertion that success stories of developed nations had nothing to play in the context of LDCs.
    E. A & B
2. Perhaps, it is an undeniable truth that one of the following factors played, more importantly than others, a major role in changing the relation between the third world and the industrial countries:
    A. Membership, in NAM, of the India and China.
    B. The political emergence of the 'Third World'.
    C. The institutionalization of the Southern Perspective.
    D. All except C
    E. None

3. One of the following is **NOT TRUE** about the New International Economic Order. NIEO was:
    A. originally designed to facilitate the development pace of LDCs
    B. simply a “fine-tune” the existing international institutions.
    C. change the unequal economic balance between the North and South.
    D. B & C
    E. All
4. Define the “developmental state” and explain the significance of its development on the debate on the relative importance of the state and the market in development_________
    ____
    ____

☑ Unit Checklist

Put an (X) mark in the boxes in front of the ideas you performed well and leave those you don’t understand blank.
I can

- Identify and Explain the dilemmas and controversies surrounding the North-South debate in IPE ☐
- Explain the rationale behind the call for the NIEO ☐
- Evaluate the debate on the possibility of development in the global south with in the guise of capitalism ☐
- Critically analyze the implication of the emergence of the notion of the developmental state on the debate on development and underdevelopment ☐

If you have any doubt about your understanding of any of the above checklists don’t hesitate to go back and refer the discussions in the sections

UNIT SEVEN

Globalization and Environment

✪ Unit Introduction

Dear distance learner, welcome to the last chapter of this module. In this unit we will discuss two very important contemporary issues of IPE, namely: globalization and the environment. It should be noted that there is no any logical or analytical relationship between this themes of contemporary IPE. The merger of these issues is only for the sake of convenience. This unit is divided in to two broad sections. In the first section we will take up the theme of globalization in terms its origin, the different aspects and its significance in transforming contemporary IPE. The second section will be devoted to the discussion of the environment, the green side of IPE. In this section the focus will be on how nations and other actors could create wealth for present generation without scarifying the interest of future generations.

Unit objectives

Dear distance learner, by the end of this unit you should be able to:

- Explain the meaning of globalization
- Identify and describe the different phases of globalization
- Evaluate the debate on the alleged benefits and disadvantages of globalization
- Appreciate the importance of the issues of environment and development in contemporary debates in the fields of IPE
- Evaluate the different approaches to the green side of IPE

Section one: Globalization

✪Section overview

Dear distance learner welcome to the first section of the last unit of this module, globalization. Despite the wide range of issues unto which the term has been applied, the meaning, nature, phases, the causes and the consequences of 'globalization' remains obscure and contentious as to flout the definition. In fact there is not only disagreement on the definition of globalization; there is also no clear consensus on whether the term 'globalization' is employed as a historical epoch, a process, a theory, or as a new paradigm. Scholars have different views on its scale, causation, chronology, impact, trajectory, and outcomes. People living in various parts of the world, of social structures and cultural zones, are affected very differently by this massive transformation. The discussion in this section, we hope, enables you to be acquainted with some of the most important issues of IPE in the area of globalization.

Section objectives:

Dear distance learner, by the end of this section you should be able to

- Explain the meaning of globalization
- Identify and describe the different phases of globalization
- Evaluate the debate on the alleged benefits and disadvantages of globalization

1.1 The Concept of 'Globalization'

? Dear distance learner, what do you understand by the term globalization?

The concept of 'globalization' is not only the most contested and controversial, it is also the most confusing topic in the social sciences. Globalization constitutes what is known as the defining 'buzzwords of our time'. It is appears to be one of the most widely used but less understood. Indeed, no one is capable of providing a precise or single definition of globalization.

Anthony Giddens defined *'globalization'* as the *intensification of worldwide social relations* which *link distant localities in such a way that local happenings are shaped by events occurring many miles away and vice versa*. Emphasizing on the intensity and scope of these linkages, F. Jameson further defines the concept globalization in a way that reflects the sense of an *immense enlargement of world communication, as well as of the horizon of a world market, both of which seem far more tangible and immediate than in earlier stages of modernity*. For D. Held, *globalization* may be thought of as a *process (or set of process) which embodies a transformation in the spatial organization of social relations and transactions assessed in terms of their extensity, intensity velocity and impact generating trans-continental or interregional flows and networks of activity, interaction, and the exercise of power*. Hence, *globalization* as a concept refers to what Roland Robertson attributed to the *compression of the world and the intensification of consciousness* of the world as a whole. In the same venue, argues J. Mittelman, the term *globalization* implies the *temporal and spatial compressions*, i.e. the time and space aspects, of social relations.

Accordingly, no simple and straightforward definition can be offered, as it is differently utilized depending on varying contexts. In very crude sense, *globalization* can be defined as a concept that refers to a variety of complex economic, political, cultural, ideological, and environmental forces that are rapidly altering our experience of the world. Since its earliest appearance in the 1960s, *globalization* has been used in both academic and non-academic circles to imply a process, a condition, a system, a force, and an age. Given that these competing labels have very different meanings, their indiscriminate usage is often obscure and invites confusion.

The term "globalization," came into popular usage in the second half of the 1980s in connection with the huge surge of foreign direct investment (FDI) by multinational corporations. This time, 'globalization' is understood as a comprehensive term used to describe and explain the emergence of a global society in which events in one part of the world quickly come to have significance for people in other parts of the world. It describes the growing linkages that connect individuals, communities, businesses, and governments around the world.

Throughout the 1990s, the components of the subject matter of 'globalization' came to include, but not confined to, the study of democratization, development, market deregulation, privatization, welfare reform, new security agendas (such as immigration and drugs), and the general retreat of all aspects of the state from policy intervention. Today, there are some common manifestations of globalization processes.

Globalization refers to a multidimensional set of social processes that create, multiply, stretch and intensify worldwide social interdependencies and exchanges while at the same time fostering in people a growing awareness of deepening connections between the local and the distant.

1.2 Phases of 'Globalization'

? When do you think globalization started?

The temporal dimension, i.e. the historical origins, of globalization is the subject of on-going contest. While many scholars situate the origins of globalization in the modern era (post 1990), others regard it as a phenomenon with a long history.

The most extreme proponents of a deep historical origin for globalization argue that globalization has been in existence since the rise of trade links among ancient civilizations of the third millennium B.C.

Others have perceived an early form of globalization in an increasing articulation of commercial links among the ancient empires (like Roman Empire, China and others). Still others regard the Islamic Golden Age as important in this early stage of globalization, when long distance and explorers established a sustained interconnection of their economies. Besides, the advent of the Mongol Empire, thereby forming the so-called *Pax-Mongolica* in the 13th C had several other notable globalizing effects. It witnessed, *inter alia*, the creation of the first mode communication in a way of international postal service. These pre-modern phases of global or hemispheric exchange are sometimes known as *archaic globalization*.

Global integration continued, in the late 15th century, for instance with the discovery of the New World, i.e. America in 1492 by Christopher Columbus, during the era of *Pax-Iberiana* [of the two Kingdoms of the Iberian Peninsula -Portugal and Castile]. The Europeans began sending of the first exploratory voyages around the Horn of Africa, and the colonized Americas affecting global events concerning ecology, agriculture, and culture in history. This phase is sometimes known as *proto-globalization.*

Globalization in its modern form was the development of the 19th century with the advent of ‘industrialization’. Industrialization, among other things, allowed cheap production of household items using economies of scale, while rapid population growth created sustained demand for commodities. Globalization in this period was certainly shaped by nineteenth-century *imperialism* that coincided the era of *Pax-Britannica*. It was in this period that areas of sub-Saharan Africa and the Pacific islands were incorporated into the world system. Meanwhile, the conquest of new parts of the globe, notably sub-Saharan Africa, by Europeans yielded valuable raw materials and natural resources for new industries.

The first phase of "modern globalization" began to break down at the beginning of the 20th century and ended in late 1920s and early 1930s, with the First World War. In the middle decades of the twentieth century, globalization was largely driven by the global expansion of multinational corporations based in the United States and Europe, and worldwide exchange of new developments in science, technology and products, with most significant inventions of this time having their origins in the Western world. Some have even criticized the financial forces of globalization as a factor in creating World War I that finally came to an end during the Great Depression in the.

The second phase of what came to be known as “modern globalization”, since World War II, is largely the result of planning by politicians to break down borders hampering trade, to increase prosperity and interdependence thereby decreasing the chance of future war. Three key institutions, labeled by a renowned political economist, Robert Gilpin, the *Unholy Trinity’* helped shape the current era of globalization: the International Monetary Fund (IMF), the World Bank, and the World Trade Organization (WTO).

Throughout most of the last half of the twentieth century, the Cold War and its alliance structures provided the framework within which the world economy functioned. Hence, this period marked the hegemony of the USA, i.e. *Pax-Americana.* The United States and its major allies generally subordinated potential economic conflicts to the need to maintain political and security cooperation. Emphasis on security interests and alliance cohesion provided the political glue that held the world economy together and facilitated compromises of important national differences over economic issues.

The end of the Cold War and the growth of economic globalization coincided with a “new industrial revolution”, or sometimes known as the ICT (Information and Communication technology) revolution, based on the computer and the rise of the information or internet economy. Technological developments are transforming almost every aspect of economic, political, and social affairs as computing power provides an impetus to the world economy. Nevertheless, globalization is by no means solely manifested in economic and political integration of nations of the world. Let us briefly discuss the dimensions of globalization.

1.3 Dimensions of Globalization

? Dear learner what do you think are the basic dimensions of globalization?

Globalization is a multi-dimensional concept that makes its strict definition thorny. Every time one comes across the term, one has to look at the context in which it is being used. To begin, for instance, with a simple dichotomy: a political scientist would certainly utilize the term differently from the context in which, say, an economist or a geographer might deploy the term ‘globalization’. With this in mind, eight major dimensions of globalization could be identified.

A. *Economic globalization*: this refers to the intensification and stretching of economic interrelations across the globe

B. *Financial globalization*- this implies the instantaneous world market in financial products and transactions in world cities across the globe continuously twenty-four hours a day *via* the privatization of government-owned banks and financial institutions. *Remittances* (money sent home by workers to their home countries) have become an important source of income for many countries.

C. *Political globalization*-. These processes raise an important set of political issues pertaining to the principle of state sovereignty, the growing impact of intergovernmental organizations, and the future prospects for *regional* and *global* governance; obviously responding to the evolution of political arrangements beyond the framework of the nation-state, and thus breaking new conceptual ground.

D. *Technological globalization* - this dimension of globalization describes the combination of computer and communication technologies and their satellite linkages that have created time-space matrix, the instantaneous transmission of information across the world.

E. *Cultural globalization*- refers to the intensification and expansion of cultural flows across the globe. The exploding network of cultural interconnections and interdependencies through symbolic construction, articulation, and dissemination of meaning of values in the forms of language, music, and images in the last decades suggests that cultural practices lie at the very heart of contemporary globalization. Items common to our everyday lives—such as the clothes we wear, the food we eat, and the cars we drive—are the products of globalization. Cultural globalization, hence, refers to the consumption of 'global products across the world, often implying homogenizing effects as with *'cocacol-ization'*, *'jeans-ization'* and McWorld.

F. *Geographical globalization* is about the reordering of space replacing the 'inter-national by trans-state practices in an increasing 'borderless', often viewed as a network of 'world cities'. This is clearly manifested in the insignificance of the physical space, i.e. distance, easing the trans-national mobility of people and other resources without any difficulty due to factors such as sophisticated communication facilities and reduction of all necessary costs. This view is tightened as the world seems to be abridged into what is now termed as the "global village".

G. *Sociological globalization* is the new imagination that sees the emergence of a single 'world society", an interconnected social whole that transcends national societies. Humanity, many argue, is moving rapidly toward a politically borderless world. Hence, we must not forget that globalization also refers to people becoming increasingly conscious of growing manifestations of social interdependence and the enormous acceleration of social interactions.

H. *Ecological Globalization* is the concern that current social trends will outstrip the earth's capacity to survive as a living planet; it aspires to be a "green political globalization". Effect of environmental degradation is shaping the global biosphere. Although at a significantly varying degrees, all countries' economic activities are intensifying the real danger of severe pollution. The world's ecological capacity is becoming insufficient to satisfy the ambitions and aspirations of the world population in a sustainable way.

In the long-term, with the increasing demography of the world, these effects can lead to increased global conflict (of all against all) over dwindling resources where the worst possible scenario would be a Malthusian catastrophe.

These dimensions are interconnected in many complex ways and are themselves subject much academic debate and animosity.

1.4 Globalization, Transnational Economy and the Nation-states

? Dear learner, what do you think are the implications of the phenomena of globalization on the international system dominated by nation states?

One of the dominant themes in the study of international political economy (IPE) is the persistent clash between the increasing interdependence of the international economy and the desire of individual states to maintain their economic independence and political autonomy. At the same time that states want the benefits of free trade, foreign investment, and the like, they also desire to protect their political autonomy, cultural values, and social structures. However, the logic of the market system is to expand geographically and to incorporate more and more aspects of a society within the price mechanism, thus making domestic matters subject to forces external to the society. In time, if unchecked, the integration of an economy into the world economy, the intensifying pressures of foreign competition, and the necessity to be efficient in order to survive economically could undermine the independence of a society and force it to adopt new values and forms of social organization.

? Can you list some of the actors involved in the process of globalization?

Globalization is an inert-play of several actors that tend to produce a meaningful impact. These actors are: *nation-states*, *firms*, *international governmental organizations* (IGOs), *international nongovernmental organizations* (INGOs), a host of other *associations* and *individuals*.

A state is defined as an organized political community. Recognition of the state's claim to independence by other states, enables it to enter into international agreements, this is not only important for the establishment of its statehood, but equally important that a state can take part in the activity of nations. Because of this need for state to enter into international agreements, globalization seemed inevitable. The interdependence of nations and states created a global community. Equally, however, the artificial division of planetary social space into ‘domestic’ and ‘foreign’ spheres corresponds to people's collective identities based on the creation of common themes. People's belief in the superiority of their own nation has supplied the mental energy required for large-scale warfare – just as the enormous productive capacities of the modern state have provided the material means necessary to fight the ‘total wars’ of the last century.

However, although most people continue to live as ‘citizens’ of a single nation, they are culturally, materially, and psychologically engaged with the lives of people in other countries as never before. These prevailing questions can lead us realize something more important as to the role and effects of multinational companies to the economic growth of any countries. The emergence of globalization and technological innovation lead international businesses venture into various investment and business domains categorize them as multinational and transnational corporations. The widespread business ventures of various MNCs significantly summon for grand capital investment and marketing researches. However, on one hand, MNCs may have varied products and business strategies to invoke and culture to practice in order to conform and maintain its income or profit generating status, yet on the other hand, MNCs contribute significant development and growth to the national economy.

Eroding the traditional autonomy of nation-states in their economic power, these corporations control much of the world's investment capital, technology, and access to international markets. Such transitional production networks allow TNC's like Nike and General Motors Corporation (GMC) to produce, distribute, and market their products on a global scale. Transnational production networks augment the power of global capitalism by making it easier for TNC's to bypass nationality based trade unions and other workers' organizations. In general the growing power of TNC's has profoundly altered the structure and functioning of the international economy, political, and social welfare of many nations.

The inevitable clash between the logic of the market and the logic of the state is central to the study of international political economy. Most economists and many political economists believe that the international economy has a positive impact on international political affairs. The international economy, many argue, creates webs of mutual interdependence and common interests that moderate the self-centered behavior of states. Underlying this benign interpretation is a particular definition of economic interdependence as dependence.

Fear that economic globalization and the integration of national markets are destroying or could destroy the political, economic, and cultural autonomy of national societies has become widespread. The clash between the evolving economic and technical interdependence of national societies and the continuing compartmentalization of the world political system into sovereign independent states is one of the dominant motifs of contemporary writings on IPE. Whereas powerful market forces (trade, finance, and investment) jump political boundaries and integrate societies, governments frequently restrict and channel their economic activities to serve the interests of their own societies and of powerful groups within those societies. Whereas the logic of the market is to locate economic activities wherever they will be most efficient and profitable, the logic of the state is to capture and control the process of economic growth and capital accumulation in order to increase the power and economic welfare of the nation.

1.5 The Debates over Globalization

? Dear distance learner, is globalization beneficial to developing countries?

The debate over globalization revolve around the question of: What are the “best rules” for governing the global politics and economy in a way that its advantages can grow while its problems can be solved?

On one hand there are supporters of globalization claiming that free trade increases economic prosperity as well as opportunity, especially among developing nations, enhances civil liberties and leads to a more efficient allocation of resources. This efficient allocation of capital, it is believed, allows consumers a greater freedom of choice. With free-market globalization, investment funds can move unimpeded from where they are plentiful (the rich countries) to where they are most needed (the developing countries). In general, this leads to lower prices, more employment, higher output and a higher standard of living for those in developing countries.

Proponents of laissez-faire capitalism, and some libertarians, say that higher degrees of political and economic freedom in the form of democracy and capitalism in the developed world are ends in themselves and also produce higher levels of material wealth. They see globalization as the beneficial spread of liberty and capitalism.

These supporters of democratic globalization, also called *pro-globalists*, believe that the first phase of globalization, which was market-oriented, should be followed by a phase of building global political institutions representing the will of “world citizens”. The difference from other globalists is that they do not define in advance any ideology to orient this will, but would leave it to the free choice of those citizens *via* a democratic process. Others view globalization simply as inevitable and advocate creating institutions, such as a directly-elected UN “Parliamentary Assembly” to exercise oversight over unelected international bodies.

On the other side of argument, there is *anti-globalization.* The "anti-globalization movement" is a term used to describe the political group who oppose the neoliberal version of globalization, while criticisms of globalization are some of the reasons used to justify this group's stance. Protests by what is called the *anti-globalization* movement are seldom directed against globalization itself, but rather against abuses that harm the rights of workers and the environment. The question raised by nongovernmental organizations and protesters at WTO and IMF gatherings is whether globalization will result in a rise of living standards or a race to the bottom as competition takes the form of lowering living standards and undermining environmental regulation. These critics see that globalization as producing greater poverty, inequality, social conflict, cultural destruction, and environmental damage.

Yet, for others, *anti-globalism* denotes either a single social movement or an umbrella term that encompasses a number of separate social movements: such as nationalists, advocates of the indigenous people, ethnic groups, etc. Hence, it would be corollary to note that *anti-globalization* also involves the process or actions taken by a state or its people in order to demonstrate its sovereignty and practice democratic decision-making.

Nonetheless, one of the key problems of the 21st century will be determining to what extent markets should be regulated to promote fair competition, honest dealings, and fair distribution of public goods on a global scale.

1.6 Challenges of Globalization in Developing Countries

? Dear student, who does benefit and/or who does lose because of globalization?

Globalization has both negative and positive aspects. Among globalization's benefits are a sharing of basic knowledge, technology, investments, resources, and ethical values. Among the negative aspects: the rapid spread of diseases, illicit drugs, crime, terrorism, and uncontrolled migration are just few to mention.

***Effect on disease*:** with globalization, the flow of information, goods, capital and people across political and geographic boundaries, has also helped to spread some of the deadly infectious diseases known to humans. Modern modes of transportation allow more people and products to travel around the world at a faster pace; they also open the airways to the transcontinental movement of infectious disease vectors; a very good example being the phenomenon of AIDS/HIV.

Terrorists: Although the total number of terrorist incidents worldwide declined during the 1990s, the number of people killed in terrorist incidents increased with intensification of globalization. Such factors like development of technologies in production and communication have tended to nurture terrorism motivated by religion and secular reasons by easing the access to a range of low-tech and high-tech weapons.

Brain drain**:** Opportunities in richer countries drive talent away, leading to brain drains. Brain drain costs the developing nations of Africa and Asian continent in billions in the employment sector and equally for students going abroad for their higher studies losing a significant foreign exchange annually.

Economic problems**:** World today is so interconnected that the collapse any part of the system would have a profound impact on the whole. In developing states, *financial instability* manifested by *hyper-inflation* and other *macro-economic uncertainties* are common due mainly to the unequal integration of the former into the working system. Unemployment and income disparity have risen where about a *half* of the Sub-Saharan Africa (SSA) people are living in extreme poverty.

Food security: These days the gradual change in diet among newly prosperous populations is the most important factor underpinning the rise in global food prices. About 850 million people suffering from chronic malnutrition in 2005. It is becoming increasingly difficult to maintain food security in a world beset by a confluence of "peak" phenomena, namely peak oil, peak water, peak phosphorus, peak grain and peak fish. Growing populations, falling energy sources and food shortages will, no doubt, create the perfect storm by 2030, the time when the world requires 50 percent more energy, food and water. Two decades later (by 2050), it is projected; the world should produce 70 percent more food to feed a projected extra 2.3 billion people.

Drug and illicit goods trade: it is reported that the global drug trade generates more than $320 billion revenue per a single year. Worldwide, the UN estimates, there are more than 50 million regular users of heroin, cocaine and synthetic drugs. The international trade of endangered species (ingredients from all parts of plants, the leaf, stem, flower, root, and also ingredients from animals and minerals of traditional medicines often incorporate) has become another area of concern in this regard.

It is important, however, to recognize that globalization is not a zero-sum game. It is not necessary for some countries to lose in order that others may gain. But to take advantage of this trend, countries will have to position themselves properly through the right policies. Clearly, those economies that open themselves to trade and capital flows on a free and fair basis and are able to attract international capital will benefit the most from globalization. Open and integrated markets place a premium on good macroeconomic policies, and on the ability to respond quickly and appropriately to changes in the international environment. While globalization raises the rewards of good policy, it also accentuates the costs of poor policy. Credibility of economic policy, once lost, has become more difficult to regain. What is now critical is the perception of markets that economic policy formulation and implementation is consistent and predictable.

This does not mean, however, that countries should seek to isolate themselves from globalization. Rather, governments must fully embrace globalization in awareness of its potential risks, and seek to provide adequate protection for the vulnerable segments of society during the process of change. This underscores the importance of flexible and well-informed policy-making, of solid, well-governed institutions, and of transparency in governance. Countries with a poor or inconsistent policy record will inevitably find themselves passed by, both from expanding trade and from private capital flows for development. These are the countries that run the risk of marginalization.

Section Two: The Green Side of International Political Economy

✪ Section overview

Dear distance learner welcome to the last section of chapter seven, the green side of IPE. In this section the focus will be on the political economy of sustainable development, which revolves around the basic question of how could the existing nation states and other actors involved in the production of wealth could produce wealth for the present generation without necessarily leaving behind a depleted environment for the coming generation. The question has raised a heated debate on both academic and policy making circles, which will be summarized in the proceeding discussion briefly.

Section objectives:

Dear distance learner, by the end of this section you should be able to:

- Identify and describe the anthropocentric and bio-centric approaches to the environment
- Evaluate the debate on the notion of sustainable development
- Critically scrutinize the development environmental regimes

2.1 Environmental Issues

? Dear distance learner, what do you think is an environment? What do you understand by environmental issues?

Generally speaking, '*environment'* refers to all of the external factors affecting an organism. Alexandre Kiss and Dinah Shelton point out (2000) that the "environment" as including: *natural resources*, both the *biotic* (fauna, and flora), or nonliving variables called *abiotic* factors, such as temperature, air, water, soil, rainfall, wind, etc.; *property*, which forms part of the cultural heritage; and the *characteristic aspects* of the landscape.

Organisms and their environment constantly interact, and both are changed by this interaction. Like all other living creatures, humans have clearly changed their environment, but they have done so generally on a grander scale than have all other species.

Natural resources are those parts of nature that have an economic or cultural value to people. In an economic sense, man-made capital and labor are also resources. The interactions of organisms with biotic and abiotic factors form an *ecosystem*. Changes in any one factor in an ecosystem can influence whether or not a particular plant or animal species will be successful in its environment. That is why; professionals in various fields, including IPE scholars, study the long-term consequences of human actions on the environment, while environmentalists as well as concerned citizens advocate ways to lessen the impact of human activity on the natural world. This has given rise to what is called *environmentalism*.

Environmentalism refers to an active engagement in protecting the environment. Two approaches underlie it: *anthropocentrism* and *biocentrism*. The first implies that the natural world and non-human life do not have intrinsic value independent of us and are there for human beings to use sustainably. Biocentrism, on the other hand, hints that the natural world or the environment is not simply there for humans to use; non-human life has an intrinsic value independent of human interests, and therefore humans ought to respect nature. The global environment is an integrated, evolving, system characterized by connections and consequently forces of environmental change do not know any national boundaries. Instead, they have an impact on what are known as *"global commons"* such as oceans and the atmosphere. These factors threatening the global environment are vast and diverse. These include, among other things:

Global Warming**:** insulation of Earth's surface is maintaining warm temperatures *via* the *greenhouse* effect. The concentration of gases like CO_2 is rising and trapping more heat within the atmosphere, causing worldwide temperatures to rise. Average global temperature also has increased by about 0.6^{o}C (1^{0} F) within the past century. The consequences of such a modest increase in temperature may be devastating.

***Depletion of the Ozone Layer*:** The ozone layer, a thin band in the stratosphere (layer of the upper atmosphere), serves to shield Earth from the Sun's harmful ultraviolet rays. In the 1970s, scientists discovered that chlorofluorocarbons (CFCs)—chemicals used in refrigeration, air-conditioning systems, cleaning solvents, and aerosol sprays—destroy the ozone layer. Each chlorine molecule has the ability to destroy a large amount of ozone for an extended period of time.

***Air Pollution*:** A significant portion of industry and transportation burns fossil fuels, such as gasoline. When these fuels burn, chemicals and particulate matter are released into the atmosphere. Although a vast number of substances contribute to air pollution, the most common air pollutants contain carbon, sulfur, and nitrogen, causing the formation of acid rain that continue to threaten the very existence of marine and sub-marine species. The leading cause of extinction is habitat destruction, particularly of the world's richest ecosystems—tropical rain forests and coral reefs. If the world's rain forests continue to be cut down at the current rate, they may completely disappear by the year 2030. In addition, if the world's population continues to grow at its present rate and puts even more pressure on these habitats, they might well be destroyed sooner.

***Water Pollution*:** Estimates suggest that nearly 1.5 billion people worldwide lack safe drinking water and that at least 5 million deaths per year can be attributed to waterborne diseases. Water pollution may come from *point sources* or *nonpoint sources*. Point sources discharge pollutants from specific locations, such as factories, sewage treatment plants, and oil tankers. Pollution from nonpoint sources occurs when rainfall or snowmelt moves over and through the ground, contaminating streams and lakes. All of these problems will be directly affected by the size of the human population. These challenges are just some of the problems that many scientists believe will continue to be alarming and, thus, reach critical proportions in the coming decades.

2.2 Development, Sustainability and Sustainable Development

? Dear distance learner, what do you think is sustainable development?

As early as the 1970s, "**sustainability**" was employed to describe an economy "in equilibrium with basic ecological support systems". Ecologists have pointed to the "limits of growth" and presented the alternative of a "steady state economy" in order to address environmental concerns.

Laszlo asserts that *sustainability* is a *worldview*, which starts with the belief that we are part of larger system-business ecology - and extends to a willingness to examine the larger socioeconomic system and how we impact it at the individual, community, and organizational levels, and eventually at the planetary level."

From the above perspective, it appears that this worldview of sustainability challenges the prevailing belief articulated over 30 years ago by Milton Friedman, the Nobel Prize-winning economist, that *"the only social responsibility of business is to make profit,"* as well as complying with all the associated explicit and implicit rules that go along with that fundamental belief. This is partly attributed to a response to theories of *limits to growth*, that we are in a condition of overshoot in which we are using environmental resources faster than they can be renewed. These days, people engaging in economic activities need to have skills of discovering sustainable value opportunities and creating sustainable value. Sustainable value creation from the existing triple bottom line (separate tracks), namely: *economic*, *environmental*, and *social*.

According to **Hasna**, sustainability is a process which tells of a development of all aspects of human life affecting sustenance. It means resolving the conflict between the various competing goals, and involves the simultaneous pursuit of economic prosperity, environmental quality and social equity famously known as three dimensions (triple bottom line) with is the resultant vector being technology, hence it is a continually evolving process; the 'journey' (the process of achieving sustainability) is of course vitally important, but only as a means of getting to the destination (the desired future state). However, the 'destination' of sustainability is not a fixed place in the normal sense that we understand destination. Instead, it is a set of wishful characteristics of a future system.

Sustainable development [SD] ties together concern for the carrying capacity of natural systems with the social challenges facing humanity. SD is a relatively recent concept in IPE, was introduced in the Brundtland Report of 1987 and further developed in the 1992 Earth Summit in Rio de Janeiro. Talking about *sustainable development,* the reference is usually made to *Brundtland Commission Report* (1987). However, the first formal treaty to refer to *"sustainable development"*, prior to Brundtland, was a 1985 ASEAN (Association of South East Asian Nations) Agreement on the Conservation of Nature and Natural Resources.

The concept of *sustainable development* in this international agreement indicates that *four* recurring elements appear to compromise the politico-legal elements. These are:

1. the need to preserve natural resources for the benefit of future generations, i.e. the principle of *intergenerational equity*;
2. the aim of exploiting natural resources in a manner which is "sustainable," or "prudent," or "rational," or "wise or appropriate", i.e. the principle of *sustainable use*;

3. the “equitable” use of natural resources, which implies that use by one state must take account of the needs of other states, i.e. the principle of *equitable use*; and
4. the need to ensure that environmental considerations are integrated into economic and other development plans, programmes and projects, and that development needs are taken into account in applying environmental objectives, i.e. the principle of *integration*.

It was two years later, the Brundtland Commission Report (1987, Vol. I, p. 90), which helped bring together the fields of study in development and environment, gave us the leading definition of *sustainable development*: “*the development that meets the needs of the present without compromising the ability of future generations to meet their own needs*.”

This crude definition of “**sustainable development”** implies that the patterns of resource use which aims to meet human needs while preserving the environment so that these needs can be met not only in the present, but also for future generations. It asserts that we should dispense our children and grandchildren an earth with environmental systems as healthy as, or healthier than those, we inherited.

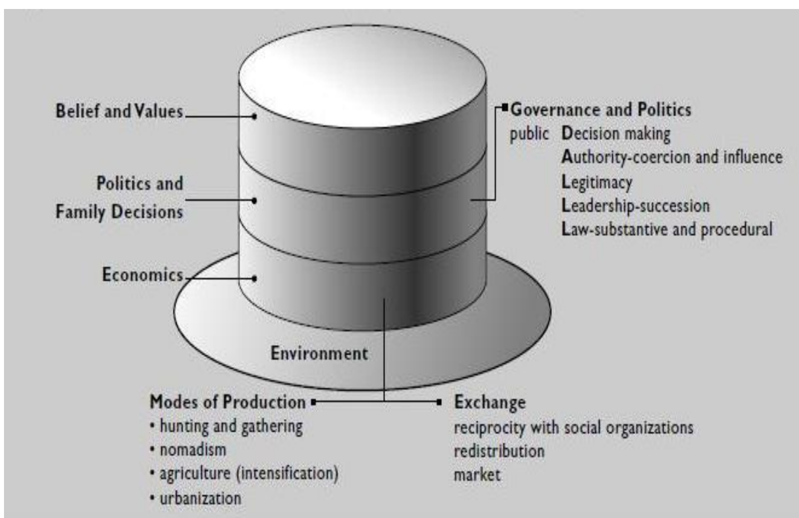
However, sustainable development does not focus solely on environmental issues. As reiterated by the UN (World Summit 2005), environmental protection alongside with economic development and social development are referred as the interdependent and mutually reinforcing pillars of sustainable development.

Basically, sustainable development also strives to balance economic and socio-political needs, on the one hand, with environmental concerns on the other continuum. Hence, the three foundational components of the concept of *sustainable development*: *environmental* sustainability, *economic* sustainability and *socio-political* sustainability. Indigenous people have argued, through various international forums such as the United Nations Permanent Forum on Indigenous Issues and the Convention on Biological Diversity, that there are *four* pillars of sustainable development, the fourth being *cultural*. *The Universal Declaration on Cultural Diversity* (UNESCO, 2001) further elaborates the concept by stating that *cultural diversity* is as necessary for humankind as biodiversity is for nature; it becomes one of the roots of development understood not simply in terms of economic growth, but also as a means to achieve a more satisfactory intellectual, emotional, moral and spiritual existence. In this vision, cultural diversity is the fourth foundational issues and policy priority area of sustainable development.

The socio-cultural dimension in the definition of the environment hints that the environment is not an abstraction. But, it represents the living space, the quality of life, and the very health of human beings, including generations unborn. The social domain—society—is best understood as a complex set of interacting cultural and institutional systems that vary from one place to another. All have bodies of knowledge for adapting to the physical environment; modes of producing and exchanging goods and services; systems for finding partners, raising children, and inheriting property; arrangements for public decision making and conflict management; bodies of belief and related rituals; and systems of prestige or ranking, and aesthetics.

An "unsustainable situation" occurs when natural capital, i.e. the sum total of nature's resources, is used up faster than it can be replenished. Sustainability requires that human activity only uses nature's resources at a rate at which they can be replenished naturally. Inherently the concept of sustainable development is intertwined with the concept of *carrying capacity*. Theoretically, the long-term result of environmental degradation is the inability to sustain human life, meaning the extinction of *humanity* all.

Figure 1 Elements of Sustainable Development



Social development is about helping people, whatever their circumstances, to overcome poverty by learning new skills, securing access to legal and other rights, developing new ways of organizing and managing their societies, and exercising responsibility for continuing change processes.

Sustainable development is an eclectic concept, as a wide array of other concepts views fall under its umbrella. One of such concepts is *green development.* However, *green development* is generally differentiated from sustainable development in that Green development prioritizes what its proponents consider to be environmental sustainability over economic and cultural considerations. Proponents of Sustainable Development argue that it provides a context in which to improve overall sustainability where cutting edge green development is unattainable. For example, a cutting edge treatment plant with extremely high maintenance costs may not be sustainable in regions of the world with fewer financial resources. An environmentally ideal plant that is shut down due to bankruptcy is obviously less sustainable than one that is maintainable by the community, even if it is somewhat less effective from an environmental standpoint.

2.2.1 Critiques and Challenges of Sustainable Development

? Dear learner, do you think that the notion of sustainable development has got a universal acceptance in both academic and policy making circles?

Some have criticized the overuse of the term itself. The word ***sustainable*** has been used in too many situations today, and ecological sustainability is one of those terms that confuse a lot of people. You hear about sustainable development, sustainable growth, sustainable economies, sustainable societies, sustainable agriculture, etc; virtually everything is sustainable.

Sustainable development is also said to set limits on the developing world. While current first world countries polluted significantly during their development, the same countries encourage *Third world* countries to reduce pollution, which sometimes impedes growth. Some consider that the implementation of sustainable development would mean a reversion to pre-modern lifestyles. Overall, the development performance of the developed countries is insufficient in terms of providing incentives to achieve sustainable development through altered consumption and production patterns. Yet if these do not change, it is unlikely that sustainable development can be fully achieved.

One point we have not touched upon is leadership. Many developing countries have governments that need to improve their performance by eliminating corruption. Their officials rob their own people and abuse their countries' resources to line their own pockets. Their greed denies future generations a secure life and a safe environment. This entails a multiplicity of problems. But positive changes come, albeit slowly. To protect the environment and to provide a better future for all people, everyone needs to lead by example. Developing countries are calling the WB hypocritical, asking it to do this and that while its shareholders are despoiling the planet. It all boils down to the "haves" telling the "have-nots" what they should or should not do, rather than showing them by example.

2.3 Towards Global and (or) International Environmental Governance

? Dear distance learner, what do you understand by international environmental governance?

Robert Keohane and Joseph Nye (2000) define *governance* as the processes and institutions, both formal and informal, that guide and restrain the collective activities of a group. Governance is the body of rules, enforcement mechanisms and corresponding interactive processes that coordinate and bring into line the activities of the involved persons with regard to a common outcome; in this context relates to the management and use of the ecosystem. Government is the subset that acts with authority and creates formal obligations. Governance need not necessarily be conducted exclusively by governments and the international organizations to which they delegate authority. Private firms, associations of firms, nongovernmental organizations (NGOs), and associations of NGOs all engage in it, often in association with governmental bodies, to create governance, sometimes without governmental authority. Hence, in this case, institutions are regarded as not only important but also necessary.

By 'institutions' we mean formal and informal rules including the corresponding measures to enforce them. Institutions can guide human behavior reduce uncertainty. They can take various shapes and forms like: established procedures of conflict resolution and agreements on the use of natural resources all of which provide the guidelines for human behavior. Governance, being a multidimensional and multi-tiered process, cannot be considered as a single actor's activity. It is the result of the interaction of a multitude of institutions, actors and mechanisms. Governance occurs whenever more than one single person makes use of a natural resource. We call governance whatever happens with regard to resource management in any given situation. These include governmental and nongovernmental actors at levels ranging from local to national to international.

Attempting to govern complex ecosystems is a dizzying array of organizations and international treaties. Different approaches have, of course, developed in this area. One of the approaches is the so-called "*Industrial Ecology*". Industrial Ecology is an approach to managing human activity on a sustainable basis by: seeking the essential integration of human systems into natural systems; minimizing energy and materials usage; and minimizing the ecological impact of human activity to levels natural systems can sustain.

However, Political Economy [PE] seeks to understand the networks of power shaping behavior and action by government, business, communications, education, science. Its subject is the level of the economy where the basic rules of the game are held. Political economic analysis is an essential and largely missing component of industrial ecology.

Kiss, in his work entitled *Sustainable Development and Unsustainable Arguments* (2003), argues that sustainable development should be considered as a concept while several principles have been proposed to establish its concrete content. The "conceptual approach" to sustainable development, suggested by Kiss (2003), comprehended from fundamental values, concepts, principles, and policies to legal tools. This includes: fundamental values of *humanity* (peace, human rights and environment); *concept* of sustainable development (like sustainable use of the environment, pollution control, equity and eradication of poverty); and *policies* (land-use planning; health care; habitat; energy; ecosystem management; soil protection; and education, awareness-raising, training, capacity building).

To achieve sustainable development and protect the environment, the communities, countries, regions, and continents of the world need reformed policies and laws as well as increased capacity of both new and existing institutions. Legislation and international law will play an important role in making these changes and developing these capacities.

2.3.1 Multilateral Environmental Agreements (MEAs)

? Dear distance learner, do you know about the Montreal and Kyoto protocol?

Major conventions, often known as *multilateral environmental agreements (MEAs)* are usually held at different periods and levels between or among nations to guide the process of global governance. They provide the basis of international environmental regulation. Sharing some common features, MEAs are forms of international legislation, and play a significant role in this process and in the achievement of sustainable development. Kiss and Shelton describe (2000) seven main features of environmental treaties. These are:

a. an emphasis on national implementing measures being taken by the states parties;
b. the creation of international super visor y mechanisms to review compliance by states parties;
c. simplified procedures to enable rapid modification of the treaties;
d. the use of action plans for further measures;
e. the creation of new institutions or the utilization of already existing ones to promote continuous cooperation;
f. the use of framework agreements; and

g. interrelated or cross-referenced provisions from other environmental instruments.

Environmental treaties are implemented with the help of small organizations called *secretariats*. Perhaps most important organizational framework is the United Nations Environment Programme (UNEP), which acts to centrally coordinate organizations and information. Few of the most important organizations, conferences, and treaties are mentioned below.

Two important international treaties are the *Montreal Protocol on Substances that Deplete the Ozone Layer* and the *Kyoto Protocol to the United Nations Framework on Climate Change*. The first is the most successful example ever of international environmental cooperation; it led to a substantial decrease in the emission of chlorofluorocarbons that harm the ozone layer. This is largely because the treaty was self-enforcing, providing a mixture of incentives and punishments. The ready availability of substitutes for chlorofluorocarbons also helped the treaty.

The legally binding instruments that emerged in Rio were two international conventions—the UN Framework Convention on Climate Change, and the Convention on Biological Diversity—both of which were signed in Rio and subsequently entered into force. The Rio Declaration of 1992 consists of a preamble and 27 principles that contain provisions more specific and precise than those adopted at Stockholm 20 years earlier. The Rio Declaration contained, among others, "the people's right to development must be fulfilled so as to equitably meet developmental and environmental needs of present and future generations." And, it provides that "human beings are at the center of concerns for sustainable development"; and that people are "entitled to a healthy and productive life in harmony with nature," all of which emphasize the concern for people in general and on the poor, in particular. Similarly, the Rio Declaration puts that women and indigenous people have a vital role and their communities in the achievement of sustainable development.

The Rio Declaration on Environment and Development also adopted at the 1992 UNCED is one of three non-binding instruments that emerged in Rio de Janeiro. The other two are Agenda 21 and the Forest Principles.

Agenda 21 clearly identified information, integration, and participation as key building blocks to help countries achieve development that recognizes these interdependent pillars. It emphasizes that in sustainable development everyone is a user and provider of information. It stresses the need to change from old sector-centered ways of doing business to new approaches that involve cross-sectoral co-ordination and the integration of environmental and social concerns into all development processes. Furthermore, Agenda 21 emphasizes that broad public participation in decision making is a fundamental prerequisite for achieving sustainable development. The Agenda 21 commitment is not binding in international law, but it does represent a political commitment.

The **Kyoto** Protocol, by contrast, has barely gotten off the ground; its ratification was delayed until 2004, and the treaty still suffers from the critical absence of the United States (which has just announced a pact with Australia, China, and other partners to update technology that fights global warming). The Kyoto Protocol limits the emission of carbon, believed to be a prime cause of global warming, while encouraging countries to create sinks to remove carbon from the atmosphere. Critics claim that the treaty was flawed from the start, relying on rigid targets and exempting developing countries (including heavy polluters such as India and China) from responsibility. The high cost of a transition away from our current energy infrastructure makes the Kyoto Protocol particularly difficult to fulfill.

In fact, in the conference held in New Delhi in April 2002, some principles of international law have been proposed to establish its concrete content in the field of sustainable development. It declared seven basic principles followed by explanatory comments:

i. *The duty of the States to ensure sustainable use of natural resources*: the sovereign states have *right* to use their own natural resources pursuant to their own developmental policies under a duty to manage them in a rational, sustainable and safe way.

ii. *The principle of equity and the eradication of poverty:* It refers to both intra-generational equity (within the current generation) and inter-generational equity (benefit of future generations). "Benefit" is to be understood in this context as including inter alia, economic, environmental, social and intrinsic benefit. Recognizing of *the right to development* adds to the duty of States to cooperate for the eradication of poverty.

iii. *The principle of **common** but **differentiated** responsibilities*: All States and non-state actors should co-operate in the achievement of global sustainable development and the protection of the environment. The *special needs and interests of developing countries and of countries with economies in transition* should be recognized. Developed countries bear a special burden of responsibility in reducing and eliminating unsustainable patterns of production and consumption and in contributing to capacity-building in developing countries.

iv. *The principle of the precautionary approach to fields such as health, natural resources, and ecosystems*: Such approach should include accountability for harm caused, where appropriate, planning based on clear criteria and well-defined goals, effective use of environmental impact assessment.
v. *The principle of public participation and access to information and justice*: this also requires a right of access to appropriate, comprehensible and timely information held by governments and industrial concerns regarding the sustainable use of natural resources and the protection of the environment.
vi. *The principle of good governance*: civil society and non-governmental organizations have a right to good governance by States and international organizations by adopting of democratic and transparent decision-making procedures and the implementation of a public procurement approach.
vii. *The principle of integration and interrelationship* (in particular in relation to human rights and social, economic, and environmental objectives): reflects the interdependence of social, economic, financial, environmental and human rights aspects of principles and rules of international law relating to sustainable development, of the needs of current and future generations of humankind as well.

According to the Declaration, states should strive to resolve apparent conflicts between competing economic, financial, social and environmental considerations, whether through existing institutions or through the establishment of appropriate new institutions; because, policy measures are necessarily linked with capable institutions.

Equally, the 2002 Johannesburg World Summit on Sustainable Development focused a large part of its work dealing with "effects upon the environment", risks for mankind—for present and future generations, and the "concept of sustainable development" as the pursuit of such interventions as an unconsidered and unabated pace, new norms and standards have been developed, set forth in a great number of instruments.

Perhaps the most significant MEA in support of sustainable development is the UN Framework Convention on Climate Change, a treaty that has been signed by more than 175 nations and for which the total number of ratifications, or accessions, or acceptances is 120 of the world states. The convention states that the Parties have a right to, and should, promote sustainable development. It further provides that Parties to the Convention must promote sustainable management, and cooperate in the conservation and enhancement of an appropriate ecosystem. This Framework appears to be the strongest multilateral environmental agreement ratified by an overwhelming majority of the planet's countries, which incorporates the phrase in field of sustainable development, which effectively gave the issue a legal sanctity throughout the world.

One of the most recent developments in the international governance of environment is the “Earth Charter”. The Earth Charter was formulated by the Earth Charter Commission, which began work in early 1997 to oversee consultations and drafting processes and to approve a final version of the Charter, which was released in March 2000, following a Commission meeting in Paris at the UNESCO headquarters. This Charter is described as an authoritative synthesis of values, principles, and aspirations that are widely shared by growing numbers of men and women in all regions of the world.

Such new norms have to be taken into consideration, and such new standards given proper weight, not only when States contemplate new activities but also when continuing with activities begun in the past. This need to reconcile economic development with protection of the environment is aptly expressed in the concept of sustainable development.

2.3.2 Problems Associated with MEAs

? Dear distance learner, can you mention some of the problems of the MEAs?

Governance problems - the haphazard development of international environmental laws and agencies has left three important institutional gaps in the existing global environmental governance system: (i) a jurisdictional gap -their role does not include addressing worldwide transboundary harms, while global bodies often do not have the capacity or the authority to address them;(ii) an information gap, arises from the little coordination among data collection efforts of international and other organizations and poor comparability across jurisdictions; and (iii) an implementation gap- this may be the biggest single obstacle to environmental progress at the global scale, and that this gap is caused by the lack of an action orientation.

Ratification and implementation problems- The UNEP publication identified 14 MEAs that had been ratified but needed assistance in implementation. One of these 14, the Kyoto Protocol to the United Nations Framework Convention on Climate Change, was ratified in 2005. As a result of this two-step procedure, some treaties are called “paper tigers”; even though they have been ratified for the purposes of international law; since they have no implementing domestic legislation, they have no teeth. To help in achieving the objectives of those agreements, the UNEP publication indicates that UNEP is committed to promote and support their ratification and to assist countries in implementing those agreements.

Availability of Financial Resources **-**The disparity in availability of funds among the various international environmental organizations is also a problem. The Global Environment Facility (GEF), with headquarters in Washington, D.C., is well funded, with a tranche of $2.92 billion. Despite the short list of MEAs, the GEF has quite enough to do. On the other hand, UNEP, which was founded in 1975 with headquarters in Nairobi, Kenya, expends in any one year less than $100 million on the entire range of international environmental issues.

Political (Willingness & Commitment) and Administrative (Capacity Building) **-** If the public does not support a program, politicians are not likely to implement it. On a worldwide basis, there is a lack of legislators, administrators, lawyers, judges, entrepreneurs, and others who are sufficiently informed or have the resources to implement sustainable development within the many constraints that confront them.

Significant support will likely be required for such international organizations as UNEP, for development banks, for governments, and for schools and universities. The lack of support, it is argued, raised no cause of action and it was a political question.

Because of the increasing globalization of environmental threats, some have called for the creation of a World Environmental Organization (WEO) more powerful than UNEP. Scholars are arguing that this organization should do for the environment what the World Trade Organization does for global trade, and should have the power to adopt treaties and enforce international regulations, taking into account the role of LDCs. The role of developing countries, sometimes called the Global South, remains fiercely contested. Advocates for developing countries argue that the wealthier countries contribute most to international environmental degradation, and so should be most responsible for cleaning it up. *Environmental justice*, particularly toward developing countries, has been heatedly discussed, although its role in international decision-making remains limited. This is partly because wealthy countries contribute the most money to international institutions, and so claim the most influence in decision-making.

UNIT SUMMARY

Dear distance learner in this last unit we have attempted to introduced to the two of the most contemporary topics in IPE, namely: globalization and environment. In the first section the focus was on the political economy of globalization. Some of the outstanding points we have raised include among other things include the following. First, there is a disagreement as to what exactly globalization both in policy making and academic circles. Consensus is also lacking on the historical development of globalization as different periods were cited by different scholars. In spite of the disagreement surrounding the very term, today globalization is a very real phenomena transforming global relations in at least eight different aspects, a point we have discussed on the dimensions of globalization. Globalization has both supporters and its discontents which are in captured in the anti-globalization movements. Consensus is also lacking as to who benefits and who loses from globalization.

In the second section we have discussed about the green side of IPE and the controversies surrounding what we called environmental issues and the notion of sustainable development. The debate on environment and the multilateral efforts to address environmental problems at the international level signaled the need for a fundamental change that requires actors to broaden the conception of their interests to include the issues of environment. This in many ways required a fundamental transformation in many levels be it in the production, financial, security or knowledge structure of the intentional economy or the debate between the global north and south, which has become another major area of contention between these traditionally opposed groups of countries.

REFERENCES

Balam, David. N. and Vesth, Michael (1996) ***Introduction to International Political Economy***. New Jersey: Prentice Hall

Baylis, John & Stare Smith (2001) ***The Globalization of World Politics: An Introduction to International Relations*** (2nd ed). New York: Oxford University Press.

Cox, Robert (1987) ***Production, Power, and World Order: Social Forces in the Making of History.*** New York: Columbia University Press

Dasgupta, B. (1998) ***Structural Adjustment, Global Trade and the New Political Economy of Development***. London: Zed Books.

Gilpin, Robert (1987) ***The Political Economy of International Relations.*** New Jersey: Princeton University Press.

Gilpin, Robert, & J.M. Gilpin (2001) ***Global Political Economy: Understanding the International Economic Order.*** New Jersy: Princeton University Press.

Hirst, P and Thomson G. (1999) ***Globalization in Question: The International Economy and the Possibilities of Governance*** (2nd ed.) Oxford: Polity Press.

Kegley, C. W. & E.R. Wittkopf [Eds.] (1995) ***The Global Agenda: Issues and Perspectives***. New York: McGraw-Hill.

Leontyev, L (1972) ***Political Economy: A Condensed Course***. Moscow: Progress publishers.

Nabudere, D. (1977) ***The Political Economy of Imperialism: Its Theoretical and Polemical Treatment from Mercantilism to Multilateral Imperialism***. London: Zed press Ltd.

Neumayer, E. (2003) ***The Pattern of Aid Giving: The Impact of Good Governance on Development.*** London: Routledge

Schotter, Andrew (1981)***The Economic Theory of Social Institutions.*** New York:Cambridge University Press.

Watson, Alison M.s (2007) ***An Introduction to International Political Economy.*** Newyork and London: continuum

Woods, Ngaire (ed.) (2000) ***The Political Economy of Globalization.*** New York: Palgrave Publisher ltd.